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THE UNIVERSITY OF HONG KONG

COMMONHOLD AS A SOLUTION TO THE PROBLEMS OF BUILDING MANAGEMENT – AN INSTITUTIONAL ANALYSIS

A DISSERTATION SUBMITTED TO

THE FACULTY OF ARCHITECTURE

IN CANDIDACY FOR THE DEGREE OF

BACHELOR OF SCIENCE IN SURVEYING

DEPARTMENT OF REAL ESTATE AND CONSTRUCTION

BY

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APRIL 2007

Declaration

I declare that this dissertation represents my own work, except where due acknowledgement is made, and that it has not been previously included in a thesis, dissertation or report submitted to this University or to any other institution for a degree, diploma or other qualification.

Signed: _____

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Date: 10th April, 2007.

Abstract

In Hong Kong the traditional system of multiple ownership in multi-storey buildings is undivided form of co-ownership based on the common law principle of tenancy in common. A legal instrument known as the deed of mutual covenant (DMC) binds the developer, the first purchasers and their successors in title on the matters of division of shares, obligations and limitations to the parties.

The undivided co-ownership system is however facing growing criticism for the associated problems of building management ranging form a deadly blazes dated back in a decade ago that sounded the alarm on fire safety to the present day concern of falling windows and facades as well as rampant unauthorized building works (UBW) claiming lives and causing injuries.

Literature explaining the causes of poor building management points to the current institutional setting for having incubated a poor social norm of free riding and lack of prescribed formation of central self-governing authority rendering transaction costs too high for pure private bargaining among owners to work. It is widely agreed that a statutory strata title system such as Commonhold in the UK will facilitate coordinated decision making and thus all together eradicate the free rider problems and address the need for contemporary building management.

Employing Oakerson's (1992) basic framework for institutional analysis of common pool resource situation and Kiser and Ostrom's (1982) three-level decision making

analysis, this study demonstrates that the Commonhold institution, as most scholars anticipate' is structurally and elementally sound and a high degree of consistency throughout the hierarchical structure of decision making is maintained. Nonetheless, it also reveals the systemic imperfection that constitutional or collective choice out of good intention can result in hindrance in decision making in lower levels. This accentuates the importance of sensible judgment and balance of outcomes as a complement, which is something not explicitly given consideration by certain advocators of the scheme.

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Chapter 1

Introduction

1.1 Background

In Hong Kong undivided co-ownership has been the traditional system of multiple ownership in multi-storey buildings. The undivided form of co-ownership is based on tenancy in common, a common law principle of concurrent ownership under which all unit owners are entitled to undivided shares of the development as co-owners, with the right of exclusive use of their units. A legal instrument known as the deed of mutual covenant (DMC) binds the developer, the first purchasers and their successors in title on the matters of division of shares, obligations and limitations to the parties. (Sihombing and Wilkinson, 1994)

The undivided co-ownership system is however facing growing criticism for the associated problems, especially those in the realm of building management. From aesthetics to safety, signs of inadequacy emerge in times, indicating that the traditional system of multiple ownership can no longer provide an institutional setting that facilitates the management of multi-storey buildings. From the deadly blazes dated back in a decade ago that sounded the alarm on fire safety (Walters and Hastings, 1998) to the present day concern of falling windows and facades as well as rampant unauthorized building works (UBW) claiming lives and causing injuries (Yiu, et el., 2004), new problems concerning the physical state and safety of buildings arise while the old ones remains unsolved. Managerial arrangements suffer as well considering the ambiguous requirements on owners' consent and conflicts between

owners and management bodies. Considering that quite a number of scholars have put the blame of poor building management on the current institutional setting (Walters and Hastings, 1998; Walters and Kent, 2000), it is not unreasonable to describe the undivided co-ownership system as more like a hindrance to proper building management.

The decision of adapting the undivided co-ownership system in Hong Kong, a substantial divergence from the legal tradition of it metropolitan state, UK, was greatly influenced by the situations in the 1950s, including the choice of leasehold tenure and the boom in multi-storey development. Technical issues like the lack of strata surveying system also contribute to the rejection of other from of co-ownership like the condominium title. Nevertheless, the aforementioned telltale signs have been giving constant reminders that what might have been a sound and convenient expediency as ‘an immediate legal solution to protect purchasers within the existing deed system’ (Sihombing and Wilkinson, 1994) can just barely survive in an era of full exploitation of development potential when redevelopment taking place before the end of the physical life of buildings is unlikely.

Literature has provided an explanation for these outcomes of poor building management. Walters and Kent (2000) point out that the current institutional setting has incubated a poor social norm of free riding, leading to great difficulty in collective maintenance actions. Transaction costs have surged to too higher a level for pure private bargaining among owners to work. Instead of decentralized collective actions, the free rider problem and high cost of transaction call for a change in the institutional setting into a statutory strata title system. Walters and Kent (2000) specifically referred to the institution of Commonhold in the UK, most probably due to the

resemblance in institutional background. It is argued that in Commonhold the prescribed establishment of a self-governing commomhold association will facilitate coordinated decision making and thus all together eradicate the free rider problems and address the need for contemporary building management.

The named Commonhold Bill was defected at the time of Walters and Kent's (2000) work. The matter of Commonhold legislation was revised and the Commonhold and Leasehold Reform Act was enacted in the year of 2002, making Commonhold the latest addition to land (and multi-storey buildings) co-ownership system of the UK. Over the last five years, the Act has undergone a series of consultation and amendment. If the institution of commonhold ideally turns out to be what Walters an Kent (2000) anticipated, it would be indeed an invaluable example of how new system of strata title is implemented in society in which traditional co-ownership systems prevails, despite to certain extent the difference in institutional setting between Hong Kong and UK. For this reason it is high time the effectiveness of Commonhold in facilitating owners' decision making was reviewed.

Inspired by Walters and Kent's (2002) approach in examining the non-statutory co-ownership system in Hong Kong with Oakerson's (1992) basic framework for institutional analysis of common pool resource situation, this study employs the same in investigating the British Commonhold institution. It is aimed to examine if the institution of Commonhold as an alternative to non-statutory common law co-ownership is as ideal as numerous scholars suggest.

1.2 Aim and objectives

The aim of this study is to examine whether the institution of Commonhold is sound

enough to make an ideal alternative to non-statutory system of co-ownership. A number of objects are set up to facilitate achievement of the aim.

1. To review the identified problems leading to poor management prevailing in non-statutory systems and find out whether they appear in the Commonhold institution
2. To review Kiser and Ostrom' s (1982) three-level institutional analysis and identify the necessary elements within the different levels of decision making
3. To evaluate the decision making arrangements of the institution of Commonhold employing Kiser and Ostrom' s (1982) three-level institutional analysis and related findings

1.3 Scope

In this study the scope of the institutional analysis is limited to the decision making arrangements of the institution of Commonhold only. Justifications for this will be in the discussion of the analytical model in Chapter 2.

This study is not, and is not intended to be an explanation of every section of Commonhold related law. Only legislations related to the identified preconditions will be given detailed examination.

1.4 Methodology

This is a qualitative research which relies very much on information from relevant legislation, government publication and journals review. Literature identifying problems leading to poor management prevailing in non-statutory systems and concerning policy reforms in the management of common recourses will be

examined.

Following the logic of Walters and Kent (2000), the institutional analysis of the Commonhold institution is based on Oakerson's (1992) framework and Kiser and Ostrom' s (1982) three-level institutional analysis of decision making rules. Through segregation of decision making rules into separate levels, the analytical framework reveals effectiveness of different aspects of the rules within each level and more phenomenally, the relationships or conflicts occurring between the three levels in the hierarchy.

1.5 Structure

The following part of the study is divided into five chapters. Chapter two covers a literature review of institutional theories including the analytical models employed in this study. Chapter three gives an overview of the Hong Kong example demonstrating the identified prime causes of poor building management commonly found in non-statutory ownership systems. Chapter four comprises an institutional analysis of the institution of Commonhold. This involves mainly segregation of decision making rules into separate levels. Implications of the revealed effectiveness of different aspects of the rules within each decision making level and more significantly, the relationships in the hierarchy will be covered in Chapter four. The final chapter draws attention to certain limitation of this study as it gives concludes this research.

Chapter 2

Theories of institutional arrangement

2.1 Definition

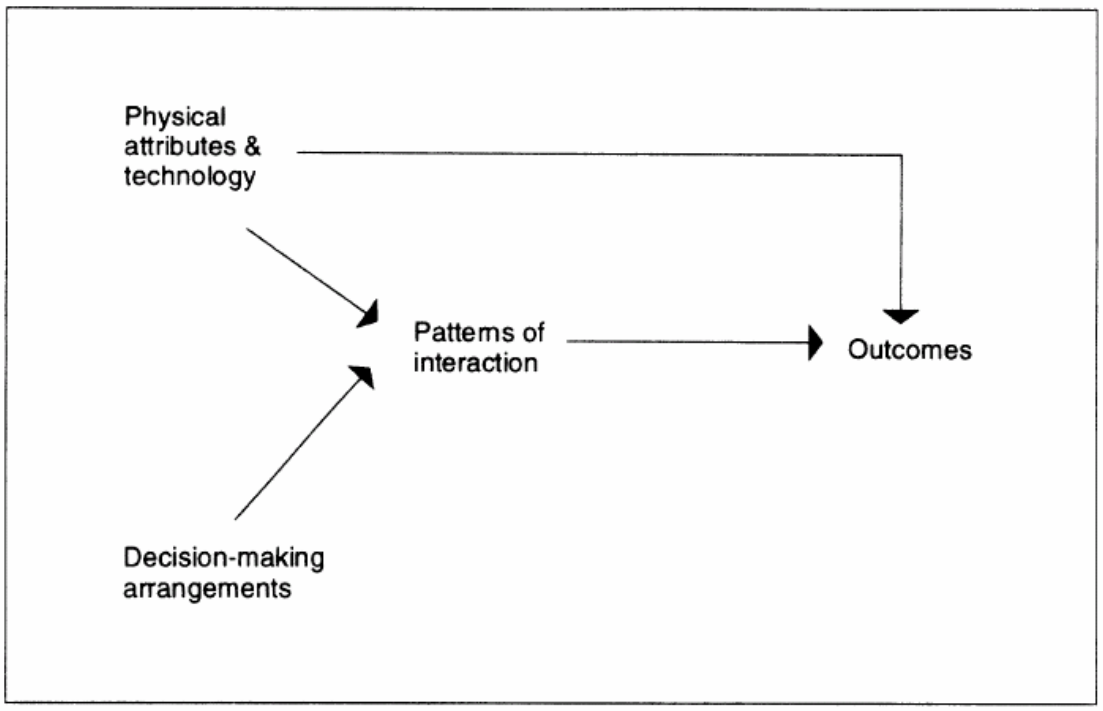
Institution in society may be defined as the set of laws, customs and societal norms that determine property rights, which in turn define the range of privileges granted to individuals with specific assets (Eggertsson, 1996).

Pejovich (1995) defines institutions as the legal, administrative and customary arrangements for repeated human interactions. In society the institutional framework comprise both formal and informal rules. While the law, including any constitutional law, legislation and regulations promulgated thereunder as well as officially declared rules make up the formal rules, informal rules often have their origins in experiences, traditional values and religious believes. In formal rules are part of the cultural heritage and its transmission from one generation to another usually relies on teaching and imitation. Depending on their origins, informal rules may complement or run against the spirit of the formal ones

2.2 Oakerson's framework

Oakerson's (1986, 1992) framework, expanded by Edwards and Steins (1998), is an analytical tool for the examination of common-pool resource situations. It identifies two separate input factors, the physical attributes of the resource and technological aids as a complement to resource constraints as well as the decision-making arrangement governing the use of the resource. The two factors have their effect on

the patterns of interaction among decision makers and users, resulting in the outcome. The heavy influence of physical attributes on the outcome is reflected by an addition line of causation from the physical component.



Source: Oakerson (1992)

Figure 1. Oakerson's basic framework

1. Physical attributes of the resource and technological aids as a complement to resource constraints

Attributes and particularly the constraints of physical assets are the root of the problems regarding commons of all types and uses (Edwards and Steins, 1998). Scholars in pursuit of understanding of the relationship between physical properties of commons and their sustainability have come up with the following concept of resource governance:

i). ‘Substractability’ (or ‘jointness of consumption’), which refers to the extent to which users are capable of subtracting from the enjoyment of other users;[1]

ii). ‘Excludability’, which refers to the extent to which access of the potential users can be controlled;[2]

iii). ‘Divisibility’, which refers to the extent to which the resource can be divided amongst the users for management purpose.[3]

Technological aids are given consideration in acknowledgement of possible, if limited control over inadequacies of the physical assets.

2. Decision-making arrangements governing the use of the resource

Decision-making arrangements, or regime, exist as sets of formal and informal rules governing appropriation of the resource. Decision-making arrangements serve to stipulate and regulate access and resource allocation and, in the event of failure to observe, provide for sanctions.

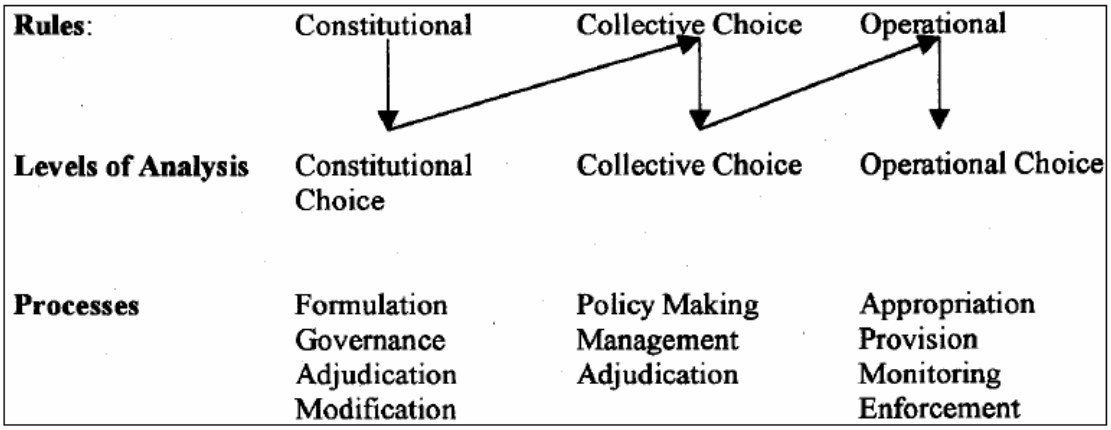
Recognizing that decision rules exist in levels and form in sequence, Edwards and Steins (1998) employ the three levels of analysis devised by Kiser and Ostrom (1982) in order to facilitate an understanding of institutional evolution and the progression of institutional change through different levels of the institutional arrangement (Edwards and Steins, 1998). The three-level institutional analysis is to be discussed in greater detail in the following chapters.

[1] Kiser and Ostrom (1982)
[2] Kiser and Ostrom (1982)
[3] Oakerson (1992), Tang (1992)

In reality in most developed cities with a burning need for building management, it is difficult if not impossible to imagine the physical nature of the asset, which is often characterized densely populated high-rise buildings in competing use, would experience dramatic changes. Only the decision-making process attached to the use of the asset can be altered (Walters and Kent, 2000). This forms the basis of seeking redress of ill building management in institutional design and justifies the focus on decision making arrangements in this research.

2.3 The three-level decision making rules analysis

Despite the lack of in-depth presentation in their research paper, Walters and Kent (2000) suggest examining the decision making arrangements of building management in Hong Kong with Kiser and Ostrom's (1982) three-level institutional analysis and the elaboration of Edwards and Steins (1998). Through segregation of decision making rules into separate levels, the analytical framework reveals effectiveness of different aspects of the rules within each level and more phenomenally, the relationships or conflicts occurring between the three levels in the hierarchy. This would ultimately facilitate an understanding of institutional evolution and the progression of institutional change through different levels of the institutional arrangement.



Source: Ostrom (1990)

Figure. 2 Linkages among rules and levels of analysis

The three levels of decision making rules affecting individual behaviour in collective choice as to common pool resources governance are:

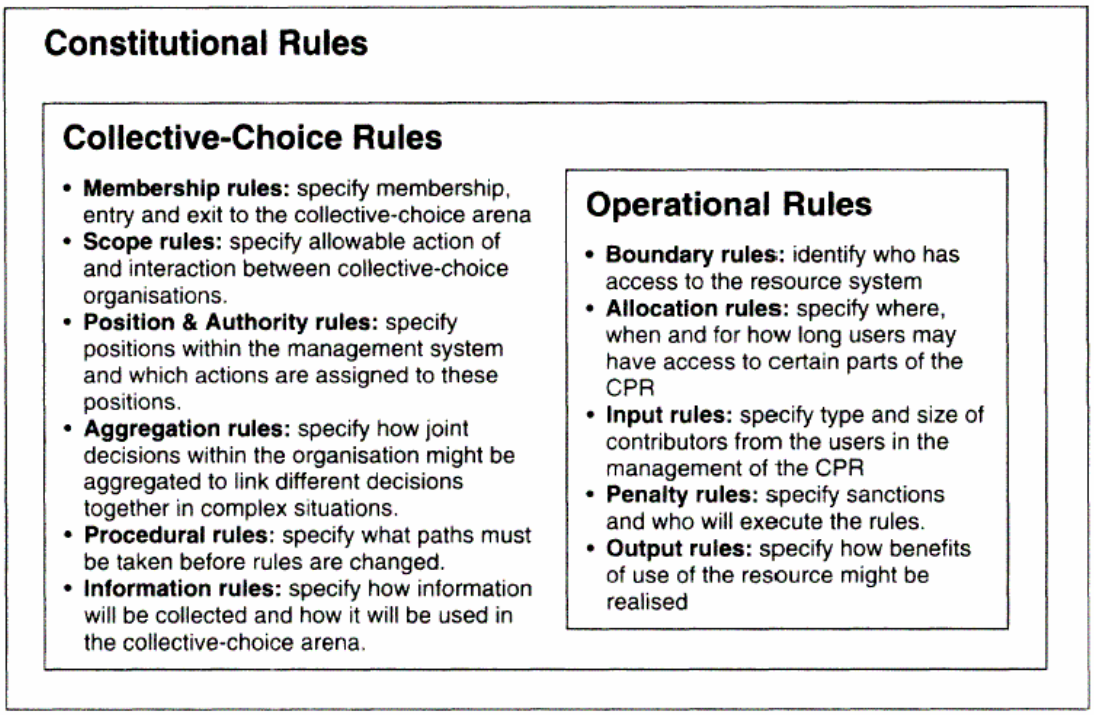
i). the constitutional level, which considers decision making arrangements external to the local community;

ii). the collective choice level, which considers interaction between the collective decision makers. The rules which affect behaviour and decisions taken at this level are derived from the constitutional level;

iii). the operational level, which considers interaction between resource users. The rules which affect behaviour at this level are derived from the collective choice level.[4]

Constitutional level is the top in the hierarchy while the operational level is the lowest. Constitutional rules prerequisite to all are formed first, then the collective choice rules within the setting of the constitutional rules and finally the operational rules subject to the previous two.

[4] Kiser and Ostrom (1982)



Source: Ostrom (1990)

Figure 3. Generic rule configuration in multiple-use common pool resources

There is no clear answer as to what decision rules should appear in the three decision levels. Definitions of the rules of decision making identified in different scholars' work were found to be simply varied (Kiser and Ostrom, 1982; Ostrom 1990; Tang, 1992). The following definitions of the three level rules are digest of different scholars' views.

2.3.1 Constitutional level

Rules of constitutional level are the top level rules governing rules of future collective decisions. On the matter of constraining future collective choices, constitutional decisions live on beyond the initial period. They form the basis of modification of collective rules as individuals react to the consequence of collective decision and

demand improvement (Kiser and Ostrom, 1982).

Constitutional decision making in Oakerson's (1992) categories of rules is part of the broader classification of external arrangements. In his understanding, constitutional rules cover not only eligibility of participation in decision making but also external decision makers' legislation and enforcement of lower level rules. Similar ideas appear in the research of Edwards and Steins (1998).

While the more common operational rules low in the hierarchy are easily recognized and conceptualized, literatures that emerged during early development of common pool resources governance are inadequate in identifying clear criteria of rules of the constitutional level. Indeed, there is much confusion concerning what exactly comprise the higher level rules (Wang, 2002). In view of the ambiguity, Wang (2002) attempts to 'decode underlying constitutional and collective choice rules based on the interpretation of operational rule. (Wang, 2002)' His definition of constitutional prerequisites is as follows:

1. Individual rights must be defined and protected. This is an inference from the polycentric governance theory Wang quotes, 'The individual person is the doer of acts. The way each individual as a person relates himself to others is the basis of all social organization.' Thus, 'individuals form the basic unit in the design of all political institution' (Ostrom, 1987).

Wang goes on to explain, 'Precisely for the reason of the importance of individual to society and theoretical analysis, definition and protection of individual rights is the first constitutional rule of the self-governance theory as well as the foundation of

other constitutional rules.'

2. Society should respect the self governance of individual citizens. 'No single center of authority need dominate all of the rest. Smaller communities of interest can be organized on principles of self-government and maintain autonomy in the governance of their own internal affairs. Other interests that are shared by several different communities can be organized as autonomous self-governing authorities.' (Ostrom, 1987)

Accentuating the importance of autonomy, Wang believes it takes more than authority granted at the constitutional level to achieve self governance. Autonomy must be free from potential intrusion by other organization, especially the government branches so as to avoid outside interference and control. Thus, the constitutional principle must strictly carry out such proposition as 'a body of men are unfit to be both judges and parties at the same time' (Ostrom, 1987).

3. The property rights must effectively exist both as a matter of law and a matter of fact. Summarizing the opinions of Wang and other scholars, two aspects of the property right issue must be considered. First, how the bundles of property rights are to be distributed among different appropriators in the system. For example, Edwards and Steins (1998) identify in their study of the New Forest the extractive use of logging and thus the private property right claimed over the felled trees by the logging parties as well as the right over the forest as a commons shared among everyone justifying the non-extractive use of leisure (Edwards and Steins, 1998). Second, how the property rights function in practice in contrast to those in legal stipulations.

4. The rule of law must exist. Wang differentiates the rule by law from the rule of law and stresses that the latter is elemental to enforcement covenants and contracts. ‘The Hobbesian assumption that “covenants, without the sword, are but words” is congruent with the American theory of constitutional decision making only when one adds “And the sword, without covenants, is but an instrument of tyranny”. Use of the sword is legitimate only when used in accord with the terms of a covenant to maintain reason and justice in the conduct of human affairs’ (Ostrom, 1987). Accordingly, a contract as an instrument to regulate and facilitate transaction is recognized.

2.3.2 Collective choice level

At the collective choice level, collective decisions are made by officials (including citizens acting as officials) to determine, enforce, continue, or alter actions authorized within institutional arrangements (Kiser and Ostrom, 1982). Collect choice rules are essentially the basis of these decisions, which give rise to rules of the operational level and regulate individuals’ actions.

Oakerson (1992) discusses the characteristics of what he calls ‘”common-property” arrangement’, rules and conditions under which a chosen group of appropriators managing commons for the benefit of all appropriators. These collective choice rules come into existence when individuals forsake their right to certain extent and participate in a process of collective choice that sets limits on individual use in return for protection of the total yield of the commons and individuals’ shares. The latter, however, is not always secured thanks to well-identified troubles of common pool resources management such as the free-rider problem. Oakerson also points out a

series of problems that management bodies are bound to encounter and settle. These may entail determination of proportion the community must agree before a course of action may be adopted, enforcement of decisions and disputes resolution (Oakerson, 1992). By prescribing voting requirements and formally vesting the management bodies with power for enforcement and sanction a well-defined set of decision rules at collective choice level reduce costs of transactions, which will encourage users to include a social motive in their decision to improve the condition of the commons leading to increased total yield (Walters and Kent, 2000). Collective choice rules are thus indispensable should challenge of authority and disputes among participants and decision makers be avoided.

Oakerson's (1992)'entry' and 'exit' rules regarding qualification for participation in a management body is further elaborated by Edwards and Steins (1998), who highlight the need for balance of power among collective choice decision makers and other user groups. Preponderance of certain majority user groups in the management body may suggests that some collective choice decision makers rated expediency over equity when devising further operational rights with their power. Examining the relative power among collective choice decision makers and other user groups would review the issue and help maintained an environment of trust for effective, unprejudiced collective choice decision making, especially in competing, multiple-use scenarios.

In addition to the aforementioned set of constitutional rules, Wang (2002) also derives from literatures on the theory of polycentric governance certain preconditions at collective choice level, attaining which would contribute to positive outcomes and sustainable development of common pool resources (Wang, 2002). They are:

1. The existence of the common pool resources governance organization. Efficient transactions among the participants require them or their representatives to form a specified CPR governance organization which ‘must engage in adopting the rules of the collective decision making of self-governance as its function so as to accomplish the goal of CPR’s rational governance and sustainable development. Such organization might not include any organization acting either toward market or under government will’ (Wang, 2002).

Within multiple ownership property, transactions between owners can either take place within an organizational setup such as a management co-operative or by private bargaining between the parties in a market situation (Walters and Kent, 2000). The existence of a governance organization for management of the common pool resources lessens reliance on the route of market bargaining, what Walters and Kent (2000) criticize as extremely costly and in essence unworkable due to the opportunistic nature of people and the free rider problem.

It is inferred that by necessitating the existence of the common pool resources governance organization, Wang implies that such an organization should have specified scope rules setting out the duties and allowable actions of the organization, the positions within the management system to which the duties are attached, as well as membership rules dealing with entry and exit of the collective choice arena.

2. The establishment and operation of sound election rules. ‘Because it is impossible for each individual CPR participant to be involved in collective decision-making process, a special selection mechanism must be up in determining who would act as representatives for the participants at large. For

this purpose, the ideal selection mechanism is a fair election and its rules. Such election rules should establish fair and reasonable election process, and allow the realization of each participant's equal and legitimate voting rights and impeachment rights' (Wang, 2002).

3. The establishment and operation of sound decision making mechanisms. Because decision making covers a wide spectrum of details, Wang's analysis suggests that a number of requirements fall within this category. A reliable decision-making mechanism must ensure that the representatives in the decision-making process fulfill their fiduciary responsibility of working in the best interest of the represented group. Their decisions ought to be free from influence of money, political power and racial discrimination.

According to the self-governance theory, the polycentric governance is improved by continuous communications and learning among participants. Face-to-face meeting is described in various literatures (Ostrom 1990) as an ideal opportunity for exchange of otherwise unavailable information regarding the parties' concerned aspects of the common assets and thus mutual understanding. Whilst sound decision making mechanisms facilitate decision making, it is the meetings for communication and decision, which should convene at reasonable rate, that initiate actions and agreement for management purpose.

Sound decision-making mechanisms at the least must contain a set of negotiation rules among participants with equal status. Wang even goes as far to assert that the outcome of negotiation and consultation must come out of true compromise and accommodation, rather than majority versus minority voting, despite the letter being

an effective last resort in most situations in light of the difficulties to compromise.

4. The establishment and operation of an effective and fair sanction system. In order to compel the users to abide by the rules for the protection of the total yield of the commons, an enforcement agency must be vested with the authority for enforcement and punishment.

Besides what Wang defines, in reality it often requires consideration of conflicts arising when exercising the power of sanction, which very much determine the feasibility of sanction by autonomous self-governing authorities. A living proof is that as a matter of law in some private housing estates, the self-governing authority are given the power to temporary impound vehicles illegally parked on the privates road with wheel locks for a fine whereas as a matter of fact, impoundment never happens as the parties try to avoid confrontation and the effectiveness of sanction is nothing more than that of a sign of warning. In these cases intervention of external official authorities is expected, which is somewhat against the spirit of self-governance.

5. The decision makers must have access to relevant information. Insufficient information is a common cause of incorrect decisions. Asymmetric information distribution would lead to irrational and incorrect rules, which bias against certain participants with relatively less information (Wang, 2002). Thus, as Wang quotes, ‘without access to reliable information about complex processes, participates may not understand the ambiguous situations they face’ (Ostrom, et al., 1994).[5]

[5] Ostrom, E., Gardner, R., and Walker, J., (1994) Rules, Games, and Common-Pool, Resources Ann Arbor: The university of Michigan Press

2.3.3 Operational level

The lowest level operational rules are of the closest relationship to daily life of common pool resources users, having immediate effects on their decision making behaviour. Rules at this level are indeed to a great extent diversified, with different commons having different sets of operational rules specific for the situation.

Edwards and Steins (1998) explain that the operational rules exist to regulate individual behaviour in the interest of maintaining the resource system at a sustainable level, i.e. its ability to continuously produce an acceptable flow of extractive resource units, or in the case of service like a building provides, to support certain amount of resource system users over time.

When devising operational rules one must also examine the patterns of use and resources subtraction from the system. Depending on the degree of the adverse effect, activities leading to depletion of the resources must be forbidden or limited in duration to prevent damage by cumulative use. Moreover, conflicts as a result of mutually exclusive use would necessitate segregation of use over time and area.

Thus, Edwards and Steins' (1998) set of operational rules governing multiple use commons comprise the followings:

i). Definition of users, such as a register of people entitled to access to the common and clarification of the details of different rights;

ii). Specification of what each of the categories of users can do, such as rules concerning the manner in which the common may be used;

iii). Details of how the different rules will be enforced, such as who will adjudicate disputes and what resource they will have in attempting to remedy issues.[6]

Wang (2002) contends that 'the well-crafted seven rules, including position rules, boundary rules, authority rules, scope rules, aggregation rules, information rules, pay-off rules, are all rules at operational level. As argued, whenever those seven rules are met, the institutional arrangement of polycentric governance might have very positive result and achieve the sustainable development of CPR' (Ostrom, 1990).

The seven well-crafted rule Wang mentioned are the design principles Ostrom (1990) concluded from an empirical study of several robust, long-enduring common pool resources institutions. Each of these design principles is 'an essential element or condition that helps to account for the success of those institutions in sustaining the common pool resources and gaining the compliance of generation after generation of appropriators to the rules in use. They affect incentives in such a way that appropriators will be willing to commit themselves to conform to operational rules devised in such systems, to monitor each other's conformance, and to replicate the common pool resource institutions across generational boundaries' (Ostrom, 1998).

Design principles illustrated by long-enduring common pool resource institutions

1. Clearly defined boundaries

   Individuals or household who have rights to withdraw resource units from the common pool resources must be clearly defined, as must the boundaries of the common pool resources itself.

[6] Edwards and Steins (1998)

2. Congruence between appropriation and provision rules and local conditions

   Appropriation rules restricting time, place, technology, and / or quantity of resource units are related to local conditions and to provision rules requiring labour, material and / or money.

3. Collective choice arrangements

   Most individuals affected by the operational rules can participate in modifying the operational rules.

4. Monitoring

   Monitors, who actively audit common pool resources conditions and appropriator behaviour, are accountable to the appropriators or are the appropriators.

5. Graduated sanctions

   Appropriators who violate operational rule are likely to be assessed graduated sanctions (depending on the seriousness and context of the offense) by other appropriators, by officials accountable to these appropriators, or by both.

6. Conflict resolution mechanisms

   Appropriators and their officials have rapid access to low-cost local arenas to resolve conflicts among appropriators or between appropriators and officials.

7. Minimal recognition of rights to organize

   The rights of appropriators to devise their own institutions are not challenged by external governmental authorities.

For common pool resources that are parts of larger systems:

8. Nested enterprises

   Appropriation, provision, monitoring, enforcement, conflict resolution, and governance activities are organized in multiple layers of nested enterprises.

Source: Ostrom (1998)

Despite Wang's claim that the well-crafted rules are operational in nature, careful scrutiny of the design principles reveals that with the exceptions of (1) Clearly defined boundaries and (2) Congruence between appropriation and provision rules and local conditions, all rules belong to either constitutional or collective choice level and constitute to a significant part of the aforementioned preconditions at the respective levels by Wang. Accordingly, preconditions at operational level should encompass the followings:

1. Clearly defined boundaries

2. Congruence between appropriation and provision rules and local conditions

Unsurprisingly, the list for operational decision making is much shorter than those for constitutional or collective choice level. This is a necessary consequence of varying conditions of different commons prohibiting more precise definition. Nonetheless, proper drafting, absence of contravention of upper level rules and participants' understanding should always be key features of sound operational rules, as well as the constitutional and collective choice counterparts.

Chapter 3

Fundamental problems in non-statutory co-ownership system – the Hong Kong example

3.1 Background of the co-ownership system in Hong Kong

In Hong Kong undivided co-ownership has been the traditional system of multiple ownership in multi-storey buildings. The undivided form of co-ownership is based on tenancy in common, a common law principle of concurrent ownership under which all unit owners are entitled to undivided shares of the development as co-owners, with the right of exclusive use of their units. A legal instrument known as the deed of mutual covenant (DMC) binds the developer, the first purchasers and their successors in title on the matters of division of shares, obligations and limitations to the parties. (Sihombing and Wilkinson, 1994)

Governing this system of co-ownership are a series of statutory law, the most prominent of which is the Multistorey Buildings (Owners Incorporation) Ordinance first enacted in 1970 and later renamed as the Building Management Ordinance in 1993. As the changing name suggests, this legislation has an expanding array of objectives in consequence of the government's practice of incremental piecemeal legislation and amendment. One of the numerous alternations made to the Building Management Ordinance is to allow the government to intervene the contractual relationship of the developer, owners and managers by prescribing certain rules in the deed of mutual covenant. Nonetheless, notwithstanding the effort in refining the

Ordinance, owners' incorporation is never made mandatory.

3.2 The primary causes of problematic building management

Adopting Oakerson's (1986, 1992) basic framework of institutional analysis, Walters and Kent (2000) identify that the defects of the institution of common law co-ownership falls in two respects, the physical context and the decision making arrangement.

The problems in physical context stem from the common ownership of a physical asset. Unlike multiple ownership by long leases in the UK which features a landlord figure with an economic interest in the asset for the self-enforcement of maintenance and repair obligations, the common law co-ownership system in Hong Kong lacks such central authority to prevent the unit owners from acting to maximize their individual utility. This results in one single problem manifesting itself in three different manners with various extent of consequence:

1. Common parts and property suffer from over utilization, which is referred to as the tragedy of the commons (Hardin, 1968). Walters and Kent point out that is no incentive for prevention of depletion in concerted effort, leading to each individual owner using as much of the common property as possible. The worst-case scenario is that common property is taken over by a particular owner for his own enjoyment.

2. The whole building or development suffers owing to the interdependence characteristic of real estate. As Walters and Kent cite 'the independent actions of nearby owners can have a dramatic effect on the value of a specific property'

(DiPasquale and Wheaton, 1996). An owner choosing to use his unit to the maximum capacity in a situation without coordination can cause externalities to the detriment of the common interest within the whole building or development.

3. The community suffers in terms of aesthetics and safety. This problem is an augmentation of the second. Buildings are not for the enjoyment of the owners only. They benefit the community by providing public goods which may take the forms of amenities, visual interest or building safety to passer-bys. Lacking coordination owners will act on their own and refuse to make contributions as such.

Since the physical context, as Walters and Kent comment, can hardly experience any change of significant degree, they believe the solution should probably lies in the arrangement for co-owners' decision making and recognition of the inadequacies in this aspect is a prerequisite.

Walters and Kent asserted that the current co-ownership system entirely fails in facilitating coordination for building management. Transactions between owners are left to take place by private bargaining in a market situation, which is doomed to failure due to self-interested behaviours and opportunistic nature of people resulting in the free rider problem. Walters and Kent illustrate this with an example of refurbishment of the common entrance lobby in a multiple ownership high-rise block, first raised by DiPasquale and Wheaton (1996). In spite of the fact that the collective rise in unit values exceeds the cost of the refurbishment, not even a single owner will be prepared to unilaterally pay for the refurbishment of the common entrance lobby simply because the cost exceeds the increase in value of any particular unit

attributable to the refurbishment. DiPasquale and Wheaton (1996) suggest that divergence between short run individual interest and the long run collective good as such is ascribable to three features:

- Non-excludable – non of the owners can be excluded from the benefit of the refurbishment
- Non-exhaustible – the benefit to each of the owners does not depend on the number of owners sharing the expense of the refurbishment work
- No enforced participation – the example assumes no contractual legal or institutional mechanism has been introduced to enforce participation by all owners, which is, unfortunately, the current situation in Hong Kong.

These features make a perfect hotbed for the poor social norm of free riding, rendering transaction cost too high for pure market bargaining to work. Instead of decentralized collective actions, the free rider problem and high cost of transaction call for coordination and enforcement by a centralized group such as formal organizations of incorporated owners. Alternation of the existing institutional rule can curtail transaction cost and redress the problem.

The second problem emerges from the agency relationship between owners and their property agent, a common one in Hong Kong. Walters and Kent argue that the appropriate from of owner organization in a scenario involving only transaction costs between owners is radically different form one with an agency relation introduced. They described the agency relationship in building management as an atypical one considering that ‘the individual principal is weak in comparison to the agent who has delegated power from all owner principals. With the agent having greater power to

undertake decisions that diverge from the principals' best interest, the residual loss of the principals' utility will be higher than in a case where there is a single principal' (Walters and Kent, 2000). It follows that high agency costs are incurred. To minimize the loss, the owners should set up an organizational structure to coordinate the decision making process and contract among themselves to form a small representative group for transacting with the agent and monitoring its actions. As Walters and Kent suggest, the current provisions of the Building Management Ordinance do not appear to address this particular problem.

Despite the simplistic presentation, the three levels of analysis of the decision making rules in the current system of co-ownership conducted by Walters and Kent reveals that the decision making mechanism in most of the rarely-existing self-governing organization (e.g. incorporated owners) is sheer a mess, be it the sharpness of the decision making rules within the individual levels or the consistency of rules between different levels. Their example concerning rules to pass resolutions and the scope of sanctions and penalties available is merely a tip of an iceberg of confusion and uncertainty surrounding the decision making rules governing the management of multi-storey buildings.

Chapter 4

Institutional analysis of Commonhold

4.1 Criteria

In this chapter the institutions of commonhold co-ownership are examined employing the three-level decision making analysis, with a slightly modified version of Wang's (2002) three sets of preconditions for the respective decision levels, listed below, as criteria of judgment.

Constitutional level

1. Definition and protection of individual rights
2. Autonomy of self-governance
3. Definition and protection of Property rights
4. Rule of law

Collective choice level

1. Existence of the common pool resources governance organization
2. Sound representatives election rules
3. Sound decision making mechanisms
4. Sound dispute resolution and sanction system
5. Decision makers having access to relevant information

Operational level

1. Definition of boundaries

2. Congruence between appropriation and provision rules and local conditions

In spite of the fact that Wang's preconditions are comprehensive summarization of wisdom of scholars on the subject, what might be unique to management of common area of building and not suit well in any of the factors are to be discussed under new, separate headings / sub-headings. It is hoped that such an arrangement would also help contribute to refinement of the three-level decision making analysis model.

4.2 Background

Commonhold is the latest addition to land (and multi-storey buildings) co-ownership system of the UK in the year of 2002 after long debate. It was first established to remedy the customary rule in the UK jurisdiction that the burden of a positive covenant does not run with the land, derived from the decision of the Court of Appeal in Austerberry v Oldham Corporation (1885) 29 Ch D 750. The Commonhold scheme provides a satisfactory way of owning and managing properties which encompass communal facilities. As the UK government prognoses, 'commonhold developments may comprise not merely housing estates and blocks of flats, but "even a complete town" … because areas of land in a commonhold need not be geographically proximate.'[7]

Essentially, commonhold belongs to the family of strata title ownership schemes under which purchasers acquire rights in relation to a layer of airspace above the surface of the strata scheme land. The commonhold scheme follows the tradition of strata title systems in the sense that owners obtain three indivisible rights: the individual ownership of the unit itself, the share of the ownership in common parts

[7] Official Report, House of Commons, 8 January 2002; vol 377, col 430

and membership of a managing body or association which has statutory responsibility for management of the strata scheme land (Van der Merwe, 1994). In the commonhold world, the notion is preserved although the rules are varied slightly in the forms of the registered freehold estate of the unit together with the exclusive membership of a private company limited by guarantee (the commonhold association) which will own the registered freehold estate in commonhold land designated as Common Parts and has statutory responsibility for management thereof.

Commonhold is governed by a combination of legislation comprising statues and regulations. They are:

i). Commonhold and Leasehold Reform Act 2002

ii). Commonhold Regulations

iii). Commonhold (Land Registration) Rules

iv). Procedures Rules

v). The Company Acts

vi). The Insolvency Acts

According to the Commonhold and Leasehold Reform Act 2002, each commonhold is established accompanied by two sets of documents, the memorandum of association and articles of association. These documents form the constitution of the commonhold association. The memorandum of association records the particulars of the commonhold association and stipulates its duties, power as well as position in relation with the external world. It is therefore a piece of solid evidence of authority conferred to the commonhold association which altogether set out the boundaries or scope of its power. On the other hand, the articles of association contains procedures and

regulations in regard to internal affairs of the organization. The articles of association is thus a principal reference for anything related to collective choice decision making, examples of which range from unit-holders' membership of the commonhold association and qualification of directors to general meeting procedures and voting mechanisms.

In addition to the memorandum of association and articles of association, created by regulations made under the Commonhold and Leasehold Reform Act 2002 is another document named the commonhold community statement. Unlike the articles of association which covers decision rules of the collective choice level, the commonhold community statement is all about the operational level with a minority of the provisions being exceptions. It contains a framework for management of day-to-day operations and control of unit-holders' behaviour within the commonhold. The miscellaneous house rules attached may be as comprehensive as forbidding nuisance and annoyance caused to others and requirements of the commonhold association directors' consent for keeping pets. The document also clearly spells out each unit-holders' rights and obligations. These rights and obligations are from three different sources, the Commonhold and Leasehold Reform Act 2002, the regulations and the applicant for the establishment of the commonhold, who are often the developer. The first two prescribe an array of mandatory terms, most of which are not permitted to change or be omitted, whereas the last is allowed to include any terms as he think fit, provided that the additional contents do not conflict with the Commonhold and Leasehold Reform Act 2002.

The repeated appearance of the guiding principles behind the formulation of the institution of Commonhold during the passage of the Commonhold Bill suggests a

need for proper remarks. The most imperative of them, the principle of uniformity of structure, is briefly discussed here.

It is of the UK Government's view that the core structural elements of the commonhold, i.e. the memorandum of association, articles of association and the commonhold community statement should be uniform. Authors of commonhold-related publications have made their comments on top of the explanation of the matters, which is quoted here:

'There is no reason why this aspiration [of uniformity of structure] should not be achieved in relation to the memorandum and articles of associations, given the comparatively limited scope of those documents and the narrow range of objectives of a commonhold association. The Consultation Paper published by the Lord Chancellors' Department on 10 October 2002 seeks to put this into practice by providing that the memorandum of association should not be capable of any amendment; and that the articles of association should only be variable in part. As the Post-Consultation Report dated August 2003 establishes, it is unlikely that there will be any significant departure from these proposals.

As far as the commonhold community statement is concerned, however, the widely differing types of development suitable for commonhold that are likely to be encountered – from a converted house containing two flats to a purpose built block containing fifty; from a mixed use marina development to a holiday chalet site; from an industrial estate to a shopping centre – make it most unlikely that substantial uniformity will be achieved in practice.

The authors suggest that a commonhold community statement which seeks to impose too much uniformity at the expense of flexibility will prove just as unpopular. The Post-Consultation Report dated August 2003 appends a draft commonhold community statement which seeks to accommodate the need for flexibility by including some provisions which are intended to be mandatory with others which may be adopted or omitted to meet the particular needs, desires and contingencies of any given commonhold association.'[8]

It is in effect this principle of uniformity that leads to the strict requirements of two of the three sets of core documents of the commonhold, the memorandum of association and the articles of association in prescribed form as well as mandatory contents to be included in the commonhold community statement. These stipulations have enormous consequences on effective management of self-governing commonhold associations and thus success of the institutional arrangement of commonhold and are to be examined in detail in later chapters.

4.3 Constitutional level

4.3.1 Definition and protection of individual rights

The Human Rights Act 1998

Since coming into force on 2 October, 2000, The Human Rights Act 1998 has been a shield of English individuals against infringement of their instinct rights by rendering it unlawful, unless by reason of an Act of Parliament, for a public authority to violate Convention rights. The Act in effect incorporates into the English legal system the Convention for the Protection of Human Rights and Fundamental Freedoms, also known as the European Convention on Human Rights (ECHR). Schedule 1 of the Act

[8] Fetherstonhaugh, G., Sefton, M., Peters, E. (2004) Commonhold, Oxford University Press, Oxford

specifies the Convention it upholds including a list of Conventional rights and protocols, which are in principle identical to the ECHR.

Article 1 of the First Protocol shown below has a particularly close tie to property ownership.

‘PROTECTION OF PROPERTY

Every natural or legal person is entitled to the peaceful enjoyment of his possessions. No one shall be deprived of his possessions except in the public interest and subject to the conditions provided for by law and by the general principles of international law.

The preceding provisions shall not, however, in any way impair the right of a State to enforce such laws as it deems necessary to control the use of property in accordance with the general interest or to secure the payment of taxes or other contributions or penalties.’

The Bill of Rights

In the British world of constitutional monarchy, it was determined that certain constitutional requirements where the actions of the Crown require the consent of the governed as represented in Parliament must be set out to reasonably limit the power of the Crown. Among the basic documents of the English constitutional law, the Bill of Rights 1689 (long title: An Act Declaring the Rights and Liberties of the Subject and Settling the Succession of the Crown) serves this purpose. The Bill of Rights 1689 is a stipulation of a number of positive rights that the English citizen / residents ought to enjoy.

The basic tenets of the Bill of Rights 1689 are that every Englishman possessed certain immutable civil and political rights, which included:

i). freedom from royal interference with the law (thus the Sovereign was prohibited from establishing his own courts or to act as a judge himself)

ii). freedom from taxation by royal prerogative, without agreement by Parliament

iii). freedom to petition the King

iv). freedom from a peace-time standing army, without agreement by Parliament

v). freedom to have arms for defense, as allowed by law

vi). freedom to elect members of Parliament without interference from the Sovereign

vii). the freedom of speech in Parliament, in that proceedings in Parliament were not to be questioned in the courts or in any body outside Parliament itself (the basis of modern parliamentary privilege)

viii). freedom from cruel and unusual punishments, and excessive bail

ix). freedom from fines and forfeitures without trial[9]

Despite its British origin, the Bill of Rights 1689 demonstrates its influence over the legal basis of other countries including non-constitutional monarchy. For instance, The Bill of Rights 1689 is a predecessor of the United States Constitution and the United Nations Universal Declaration of Human Rights. Even the aforementioned European Convention on Human Rights bears some form of resemblance to the Bill of Rights 1689.

4.3.2 Autonomy of self-governance

The communal facilities and common parts of a development is undoubtedly a form

[9] Bill of Rights 1689

of common pool resource. Commons of this kind are quite unlike the traditional natural resource commons such as forest, lakes or even electromagnetic spectrum[10] from which units of resource are extracted or utilities derived for the benefits of a major group comprising people of a region, province or the whole nation. They are different in the sense that while the government is often keen to retain considerable power of control over appropriation of the latter but comparably less over the former. This phenomenon characterized by resources largely held under anarchy or near anarchy is explained by the fact that these resources simply cannot be controlled effectively by one or more governments[11]. Essentially these commons in the developed world are given much cost-driven 'respect' as a result. The commonhold commons is unlikely an exception.

This is not to say the UK government is unaware of the externalities of city image and safety problems brought by privately owned buildings, nor is it ignorant of the need to manage. In fact, the government has done its best to prepare a well-planned strata title institution in which self-governing commonhold associations operate under minimized governmental or other external intervention and externalities are internalized.

Throughout all levels of decision making there is no lack of proof of the government's intention that the self-governing commonhold associations should be free to devise their own rules and deal with the affairs of the commonhold. The originally mandatory appropriation rules in the commonhold community statement, for instance,

[10] Ryan, P.S. (2004) Application of the Public-Trust Doctrine and Principles of Natural Resource Management to Electromagnetic Spectrum, Michigan Telecommunications and Technology Law Review, 10(2), p. 285.
[11] Lai, W.C. and Yu, T. (2003) The power of supply and demand, Hong Kong University Press.

were made optional in the revised draft so that commonhold associations can tailor these rules to suit their commonhold. The dispute resolution mechanism at the collective choice level is also moulded based on the same belief in the way that conflicts concerning the commonhold are preferably resolved by the commonhold association.

Although that the institution of Commonhold was not made compulsory has indeed attracted much criticism during the passage of the Common Bill, it is justifiable to believe the arrangement is a result of not only the government's respect to the power of the market but also one to the commons (common parts of building) appropriators' choice regarding formation of a self-governing organization in which they have the rights and duties to administer their matters. As the Minister explains during the Second Reading in the House of Commons:

'… we believe that commonhold offers enormous attractions, but it would be wrong of us to prescribe it at this stage. The property market is complex and fluid, and we think that the scheme should have time to bed in. We want to see how the market responds to commonhold, so the answer … is, in short, "Let the market decides." We believe that it will make the appropriate decision and recognize the full advantages of commonhold.'[12]

4.3.3 Property rights

A sound system of property must be backed by a legal system in which rule of law prevails. As a matter of law, the aforementioned constitutional law, being a significant part of the established rule of law, has facilitated shaping a solid private property

[12] Official Report, House of Commons, 8 January 2002; col 428

system. In the English common law system, since grants of allodial titles are non-existent, the greatest extent of the private property rights in landed interest lie in a fee simple absolute. According to the government's policy, freehold estate in the commonhold units should be nothing less than the standard fee simple owners'.

The property right system is realized in the institution of commonhold. Numerous provisions were drafted in unit-holders' favour in respect of protecting their freehold interest, even thought in some cases detriments inevitably follow. Specifically, the Commonhold and Leasehold Reform Act 2002 makes it undoubtedly impossible for a commonhold community statement to prevent or restrict the transfer of a commonhold unit[13], irrespective of the transfer being a gift or for consideration. On the matter of sanctions in relation to defaulting unit-holders, the government insisted that forfeiture, a remedy available to a holder of superior interest to prematurely terminate an inferior interest, should never be made available to the commonhold associations due to non-existence of 'landlord and tenant relationship' as such. All this tiny little bit of manifestation of the private property right system, coupled with the constitutional law, reflects the government's determination in maintaining a sound legal system in which the private property right system operates without distortion both in theory and practice.

4.3.4 The rule of law

The first step to rule of law is the existence of law. Since 1189, time before which was marked as time immemorial, common law has been a core element of the English law system. The common law system is based on the notion of stare decisis, requiring that precedents must be recognized. That is, the decision of a court binds future decision

[13] Section 15(2), Commonhold and Leasehold Reform Act 2002

of the courts of the same or lower level when they encounter a case of similar nature, save that legislature provides to the contrary or a higher court overrules the judgment. This imparts the legal system with certainty in operation and predictability in the outcomes.

As the legal system evolves, the doctrine of separation of power materializes as the judiciary is separated from the administrative and legislative bodies. The result is that judges are no longer eligible for making law as they could do in the ancient times. Another important doctrine, judicial independence, is up to ensure that the judiciary is unbiased and free from governmental, political or private influence. Judicial independence is safeguarded by a number of measures in the UK, including an independent appointment system in which selection is made by senior members of the judiciary, security of tenure which lasts for a lifetime and judicial immunity shielding members of the judiciary from actions against them for their official conduct.

Moreover, the common law system incorporates the concept of natural justice, which refers to certain legal principles that naturally exist and requires no enactment to be applied. Natural justice functions on the ground that man is by nature good and benevolent, that a person of good intent should not be harmed, as well as that one should treat others as one would like to be treated[14]. Some identified rules of nature justice are given below:

i). A person accused of a crime, or at risk of some form of loss, should be given adequate notice about the proceedings including any charges against him.

ii). A person making a decision should declare any personal interest they may have

[14] Brogan, M., Gleeson, W., Foley, T., Siow, V., and Ejsak, T. Heinemann Legal Studies p12-13

in the proceedings.

iii). A person who makes a decision should be unbiased and act in good faith. He therefore can not be one of the parties in the case, or have an interest in the outcome. As the Latin maxim goes, 'nemo judex in sua causa', i.e. no man is permitted to be judge in his own cause.

iv). Proceedings should be conducted so they are fair to all the parties. This is expressed in the Latin maxim 'audi alteram partem', i.e. let the other side be heard.

v). Each party to a proceeding is entitled to ask questions and contradict the evidence of the opposing party.

vi). A decision-maker should take into account relevant considerations and extenuating circumstances, and ignore irrelevant considerations.

vii). Justice should be seen to be done. If the community is satisfied that justice has been done, they will continue to place their faith in the courts.[15]

Besides the common law jurisdiction, an array of legislation makes up the rule of law covering aspects such as crime, property and tort.

With all these legal principles, sophisticated mechanisms and accurate realization thereof, the legal system wherein the institution of Commonhold operates is one in which not only the existence of rule of law but also the high standard of law as well as the embedded fairness and justice are treasured and upheld.

4.4 Collective choice level

4.4.1 The common pool resources governance organization

[15] Binmore, K. (2005) Natural Justice, Oxford University Press

Existence of a self-governance organization

The self-governance / management body in a commonhold is the commonhold association. The commonhold association exists as a company limited by guarantee recognized in law[16], the purpose of which is to manage the commonhold[17]. In fact, commonhold associations are formally incorporated and registered under the Company Act 1985, which governs the operations of common associations in the same way as it does to conventional companies, unless there are express provisions to the contrary.

Among the submission to the Register of Companies for registration, the memorandum of association and articles of association are two important documents that contains the core sets of rules for the collective choice decision arena.

Authority and scope of actions

The drafting of the memorandum of association runs in the spirit of the commonhold institution in that it must follows a prescribed form. Provided in the memorandum of association, along with the numerous necessary details such as the name and status of the commonhold association as well as members' limited liability, are the objects for which the commonhold association is established. The object of the commonhold association is twofold. The primary object is stated in paragraph 3 of the memorandum, which reads:

'[The objects are] … to exercise the functions of a commonhold association in relation to [specify the name of the commonhold and its location] in accordance with

[16] Section 34(1), Commonhold and Leasehold Reform Act 2002
[17] Section 35, Commonhold and Leasehold Reform Act 2002

the commonhold community statement, as amended from time to time, and any provision made by or by virtue of the Commonhold and Leasehold Reform Act 2002 ("the 2002 Act") and the doing of all such things as are incidental or conducive to the attainment of that object.'[18]

Secondarily, the original draft memorandum of association state the possible actions in which the commonhold association is allowed to take as various means to further the object of carrying out the function of the association, although they are somehow omitted after revision. These range from the power 'to make, administer and enforce provisions regulating or limiting the use of the Common Parts or any specified parts thereof'[19] to that 'to insure (and use the proceeds of insurance for the purposes of rebuilding or reinstating), repair and maintain the commonhold or any part or parts thereof, including the Common Parts and any of the Commonhold Units.'

In other words the memorandum of association is the fundamental source of authority which all together sets out the boundaries or scope of the commonhold association's power. This officially vested authority is vital support of upholding the self-governing commonhold associations' decisions.

Membership of the collective choice decision making arena

Membership rules of the commonhold association decide who has the rights to participate in decision making at the collective choice level decision making arena. Occasionally the eligibility of a member and thus validity of his vote by virtue of the membership rules may be so critical that it alters the outcome of the vote about a

[18] Paragraph 3 of the draft memorandum of association
[19] Paragraph 4.5 of the draft memorandum of association

controversial proposal. In view of this, the Commonhold and Leasehold Reform Act 2002 impose well-defined restrictions on the eligibility of membership[20], the nature of which varies as the development approach three different stages.

During the pre-commonhold period beginning with the incorporation of the commonhold association and ending with the registration of the land as commonhold, the subscribers, who are the ones having subscribed their names to the memorandum of association and applied for incorporation of the commonhold association[21], are entitled to be the members of the commonhold association. With their names entered in the register of members, the subscribers' memberships are unquestionably manifested[22], as the subsequent members' should be.

During the transitional period starting from the registration of the land as commonhold till the first unit-holder gains his entitlement to be registered as the proprietor of a unit, the aforementioned subscribers are still the members of the association. The developer may during this period make himself an addition to the membership.[23]

After the end of the transitional period denoted by the first unit-holder being entitled to register as the proprietor of a unit, the commonhold proceeds to a stage when co-ownership comes into exists, therefore needs for management arise and collective choice decisions are to be made. This is the stage in which self-governance actually concerns. Since then the unit-holders are the only group of people who can become

[20] Schedule 3, part 2, paragraph 10, Commonhold and Leasehold Reform Act 2002
[21] Section 1(1), Companies Act 1985
[22] Section 22(1), Companies Act 1985, this section is expressly mentioned to apply to a commonhold association subject to Schedule 3
[23] Schedule 3, Part 2, paragraph 5(3), Commonhold and Leasehold Reform Act 2002

members of the commonhold association[24]. It should be noted that the membership of the commonhold association is, along the traditional line of strata title schemes, an indivisible right attached to ownership the corresponding units[25]. The membership to certain extent is also a compulsorily imposed obligation which is not possible to be ridded of by resignation. On the other hand, the original subscribers and developer can resign their membership, but they can choose not to do so even if they retain no ownership of any units.

Alternation of the collective choice rules for decision making

The participants of the collective choice decision making arena have the right to decide whether alternations to the governing decision rules should be approved. The collective choice rules for decision making in a commonhold are set out in the two sets of principal documents, the memorandum of association and articles of association. Alternations to these constitutions of the commonhold association require passage of a special resolution[26]. To avoid ambiguities, the alternations, which must also be in line with the prescribed forms of the documents, are to be registered with the Land Registry and only by doing so would the alternations take effect.[27]

The success of the institution of commonhold, as numerous other institution governing common pool resources do, very much relies on a collection of unambiguously delineated, non-conflicting decision making rules in hierarchical order. Efforts were made to secure the absence of contraventions between rules of different levels. The Commonhold and Leasehold Reform Act 2002 expressly specifies that any

[24] Schedule 3, Part 2, paragraph 10, Commonhold and Leasehold Reform Act 2002
[25] Schedule 3, Part 2, paragraph 12(a), Commonhold and Leasehold Reform Act 2002
[26] Section 4(1), Companies Act 1985
[27] Schedule 3, part 1, paragraph 3(1), Commonhold and Leasehold Reform Act 2002

provision in the memorandum or articles of association contravening the regulations has no effects[28]. Any unit-holder who considers that the memorandum or articles of association are inconsistent with the regulations may launch an application to the court for a declaration to such effect.[29]

Termination

The commonhold development may eventually come to an end. At that time it is necessary to have certain guidelines for the commonhold association to dispose the company's assets and redistribute unit-holders' contribution, which could easily have been subjects of disputes.

The Commonhold and Leasehold Reform Act 2002 specifies comprehensively the procedures to handle the winding-up of commonhold associations. The situations of termination are separated into two categories, compulsory winding-up and voluntary winding-up.

In a situation of compulsory winding-up, willingness of the commonhold association membership is irrelevant. The regular procedure for compulsorily winding-up an ordinary company under the Insolvency Act 1986 is equally applicable to the commonhold association subject to several modifications. No moratorium is imposed on the compulsory winding-up of a commonhold association.

The situation is a bit different for voluntary winding-up. Given the additional element of individual unit-holder' willingness on the matter of winding-up, the rules on

[28] Schedule 3, paragraph 2(4), Commonhold and Leasehold Reform Act 2002
[29] Section 40(1)(a), Commonhold and Leasehold Reform Act 2002

voluntary winding-up must safeguard the objecting group's interests especially in the absence of unanimity as they streamline the termination process. Again, the procedures for voluntary winding-up of a commonhold association follow those for an ordinary company laid down in the Insolvency Act 1986 subject to several modifications.

It is worth mentioning that prior to the winding-up resolution, the commonhold association must pass a termination-statement resolution[30], absence of which would avoid the winding-up resolution[31]. The termination-statement resolution[32] approves the terms in the termination statement, which dominates the allocation of the commonhold association's assets and transfer of legal estate in the units and common parts to respective owners.

As for the winding-up resolution, the requirement for passage is stricter than that for a common solvent company, demanding at least 80 percent of the members of the association voting in favour, compared with a three-fourths majority vote for the ordinary ones. Such increased difficulty is by reason of protection of the objecting parties but should also be a result of favour in the commonhold. These notions further extend to the appointment of the liquidator for the commonhold association. The commonhold association can appoint the liquidator in general meeting only if the winding-up resolution was passed by unanimous vote. Otherwise, another procedure, distinguished by appointment of liquidator by the court, applies. In this way, it ensures that the liquidator for the commonhold association is a neutral person who does not act with bias against any parties.

[30] Section 43(1)(b), Commonhold and Leasehold Reform Act 2002
[31] Section 43(1), Commonhold and Leasehold Reform Act 2002
[32] Section 43(1)(b), Commonhold and Leasehold Reform Act 2002

4.4.2 Representatives and election rules

Representatives of the members of the commonhold association

A commonhold association is a company limited by guarantee. The representatives for the members of an organization as such are the board of directors who bear the responsibility of running the commonhold for the benefit of the members[33]. Qualifications of the representing directors and rules concerning their appointments, being internal affairs of the commonhold association at the collective choice level, are bound by the articles of association. The size of the board should be two at the minimum[34] whereas the maximum number of directors should either be six or a number to be determined by an ordinary resolution of the commonhold association as the original draft prescribed form of the articles of association stipulates, despite the subsequent draft being silent on this matter.

Nomination rules

The appointment and removal of directors are along with other internal affairs governed by the articles of association. Articles 46 to 54 of the draft prescribed form provide different procedures for appointment and removal of directors under several possible circumstances. Summarized below are the most significant of the said provisions.

The developer, subject to the rights granted in the commonhold community statement, may appoint up to two directors during the transitional period and remove or replace any of the directors he has appointed. After the end of the transactional period,

[33] Section 35 Commonhold and Leasehold Reform Act 2002
[34] Article 45, draft prescribed form of articles of association

provided that the developer still retains ownership of more than one-quarter of the units, he is given the right to appoint one-quarter of the maximum number of directors in total as well as the right of removal and replacement of the above. Directors appointed in this way should cease to hold office once the develop ceases to be the owners of more than one-quarter of the units.

After the end of the transactional period, the commonhold association may by ordinary resolution appoint directors and decide which directors would fall within the one-third who should retire by rotation at the annual general meeting as the law prescribes. However, other than proposal by members with voting rights, there exists another route for appointment of directors, appointment by other directors' recommendation. A new director cannot be appointed unless either he is nominated by the directors or notice has been given that his appointment is proposed.

The mechanism for resolution regarding election of director is discussed together with decision making rules for other matters below under the heading of decision making rules.

Qualifications of directors

As reasonably expected, members of the commonhold association have to right to become a director. According to Article 44 of the articles of association, however, a director of a commonhold association need not be drawn from the ranks of the members, i.e. he can be a non-member[35]. The directors of a commonhold association can well be professional directors appointed by the members to run the commonhold association on their behalf. This nonetheless necessitates protection for the members'

[35] Article 44, articles of association

rights and upholding their sovereignty over matters like recommendation of directors just mentioned. Article 44 must be amended to give such effect that at least one director must be a member of the commonhold association should the commonhold in question comprises more than six units[36].

Powers of directors

Unless provided to the contrary, the business of the commonhold association should be managed by the directors who may exercise all the powers of the commonhold association[37]. To be specific, a director's power entitle him to attend, speak and propose a resolution at any general meeting of the commonhold association, notwithstanding that he might not be a member director.[38] In such case, he has no right to vote on the resolution. There is a notable exception though. Non-member directors can still influence the outcome of the resolution and thus commonhold affairs in such a way that the chairman of the meeting has the right to a casting vote, regardless of his membership status.

Among the directors' powers, there is also the power of delegation. The directors of the commonhold association may delegate their powers to a committee comprising two or more directors, members of the commonhold association and others on the condition that the members of any committee of this kind should from time to time consist of members of the commonhold as the majority.[39]

Powers of the directors may also be delegated to managing directors or agents who

[36] Section 13(4), commonhold regulations
[37] Article 56, articles of association
[38] Article 69, articles of association
[39] Article 58, articles of association

the directors deem fit to desirably exercise such power[40]. The delegations may be accompanied by conditions imposed by the directors and depending on the situations, be altered or revoked. Delegation of power must be made in accordance with the commonhold community statement. Moreover, it is set out in the articles of association that certain procedural requirements and constraints on delegation must be observed. Highlighted below are the two most influential respects. Any delegation of power in the aforementioned manner must be sanctioned by ordinary resolution by the members of the commonhold association. Besides, it is stipulated that a record of details of power having been delegated must be properly kept. This is a crucial measure to clarify accountability and aid supervision of the agents' functioning, the latter being one of the duties of the directors under the articles of association[41].

By delegation of their powers the directors could utilize the expertise of the managing agents to facilitate management of the commonhold. The delegation itself, however, constitutes to nothing in terms of excluding the directors' liabilities for non-performance of his duties[42].

Duties of directors

As subsection 2 of section 35 of the Commonhold and Leasehold Reform Act 2002 quoted below provides, the directors of the commonhold association are obligated to manage the commonhold.

'The directors of the commonhold association shall, in particular, use any right, power, or procedure conferred or created by virtue of section 37 for the purpose of preventing,

[40] Article 57, articles of association
[41] Article 77, articles of association
[42] See Lubrano v Proprietors of Strata Plan No 4038 (1993)

remedying, or curtailing a failure on the part of a unit-holder to comply with a requirement or duty imposed on him by virtue of the commonhold community statement or a provision of this Part.'[43]

Virtually all this subsection expressly states is that the duty to manage entails the duty to enforce the various rules of the commonhold against unit-holders (the targets of enforcement should include the tenants of the unit-holders as well[44]). What exactly are to be done remain contentious without any hints on the tangible duties of the directors.

For the sake of comparison between the vague provisions of the Commonhold and Leasehold Reform Act 2002 and the procedures and operations the directors may get involved, listed as follows is an adopted summarization highlighting the major responsibilities of the board of directors.

The major responsibilities of the board of directors of a commonhold association

a. Keeping proper records of the members and business of the commonhold association
b. Holding annual meetings of the commonhold association
c. Ensuring that proper personnel are engaged to perform the required tasks
d. Ensuring the proper maintenance o the commonhold
e. Maintaining adequate insurance cover for the commonhold
f. Preparing budgets and assessments for regular expenditure and for the reserve fund

[43] Section 35(2), Commonhold and Leasehold Reform Act 2002
[44] Section 35(4), Commonhold and Leasehold Reform Act 2002

g. Ensuring that proper accounts of income and expenditure are prepared

h. Maintaining and operating a proper internal complaints procedure

i. Enforcing the provisions of the commonhold community statement, the memorandum of association and articles of association and the provisions of the Commonhold and Leasehold Reform Act 2002 and regulations made under it.[45]

4.4.3 Decision making mechanisms

Entitlement to vote

According to the Commonhold and Leasehold Reform Act 2002, generally unit-holders are the only group of people who can become members of the commonhold association and enjoy the attached right to vote in meetings of the association. However, from time to time special circumstances compel deviations form this principle. In such cases the non-member who is entitled to vote may be a receiver in the event of disability or financial difficulty of members, a mortgagee who has interest in a commonhold unit, the chairman of a meeting, a tenant of the members or a proxy appointed by members.

Mental health disability

When a court has made an order concerning that an otherwise eligible member is in a state of mental disorder resulting in disability, the articles of association provides that the member's receiver or other person authorized in that behalf appointed by the court may vote on behalf of the disabled member.[46]

Financial disability

[45] Fetherstonhaugh, G., Sefton, M. and Peters, E. (2004) Commonhold, Oxford University Press
[46] Article 35, articles of association

The voting right is vested in the receiver appointed by the court or by a mortgagee, an administrator, a trustee in bankruptcy a commissioner in sequestration or other persons who are in a similar role in the event of financial difficulty such as bankruptcy of a member.

In both scenarios of disability, for the relevant persons to exercise their rights to vote in the commonhold association meetings, evidence of their authority must be furnished to the directors' satisfaction. There is no requirement of disposition in advance, though, making it possible to present the evidence during the meetings.

Mortgagees' right to vote

Entitlement to vote can be claimed by the mortgagee who take possession of a unit on the unit-holder's defaults on payment of monies due if notice by him is served to the commonhold association declaring that he has exercised his right to possession of the unit.[47]

Tenants' right to vote

In their own rights tenants of unit-holders enjoy no privileges to vote in meetings of the commonhold association but subject to the unit-holder's it is possible for the tenants to vote in place of the unit-holder. Under the institution of Commonhold this is left to be a matter of private dealing between the two parties

The chairman's right to vote

The chairman is entitled to a casting vote regardless of their membership status.[48]

[47] Article 36, articles of association
[48] Article 27, articles of association

Proxy voting

If a member of the commonhold association is not available for voting, he can appoint a single person, the proxy, to represent him and cast his vote. A number of provisions exist in the articles of association for systemic control of arrangements of this kind, imposing constraints on both the appointing members and their proxies. The articles restrict that only if votes are to be taken by poll are proxies allowed to vote on behalf of the members[49]. In this regard, members are supposed to instruct their proxies to demand a vote by poll. As for the members who intend to appoint a proxy, notice in accordance with the form provided in the articles of association must be served to the commonhold association[50]. For those who would like to have their proxies representing them in a series of general meetings over a period of time, give instructions on the nature of the vote or limit their proxies' freedom to act, similar prescriptions are made on the various forms of notice for these special instructions which must also be observed in declaring their intention to be represented in a specific manner.[51]

Votes per member

The number of votes to which each member should entitle has been very much a controversy indeed. In principle, the Commonhold and Leasehold Reform Act grants every member of the commonhold association as many votes as the number of units he owns. The principle of 'one vote per unit', however, may not be fully realized by reason of the mechanism of voting. The votes subsequent to the first a member is entitled to counts only in a vote by poll but not one conducted on the default mode of

[49] Article 38, articles of association
[50] Article 39, articles of association
[51] Article 40, 41, articles of association

show of hands. The only relief available to members holding multiple units who would like his all his votes to be counted is to insist upon a vote by poll, which can only be demanded by the chairman, a minimum of two members having the right to vote, or a member or members representing not less than one-tenth of the total voting rights of all the member having the right to vote at the meeting[52].

Quorum

In order to ensure the decisions of the commonhold association are made as a result of collective choice representing the views of the majority members, the articles of association provides that no business may be transacted at any general meeting unless a quorum is present[53]. As the original articles of association provides, a quorum usually adopted in ordinary companies was put forward, requiring 20 percent of the members of the commonhold association entitled to vote upon the business to be transacted, or two members of such status, whichever is the greater, be present or represented by proxy.

In spite of the quorum requirement, it was identifiable that in certain situations especially when the unit-holders show no enthusiasm in collective decision making, the definition in percentage may easily render the affairs of the commonhold association under domination of a small collaboration. A demonstration of such outcomes would be that for a commonhold association with ten members, only a quorum of two is needed. In cases as such, certain requirements on the types of resolution like a unanimous resolution, are nothing more than that the more lenient ones like a special resolution (75 percent), would demand.

[52] Article 23, articles of association
[53] Article 16, articles of association

The solution given by the revised draft is to set, depending on the type of resolution, percentage requirements and the minimum number of members required, whichever greater, for a quorum. This results in what the following table presents:

Type of resolution	Percentage of members require for quorum	Minimum number of members required
Ordinary	20	3
Special	35	4
Unanimous	50	5

If the requisite quorum is not present within half an hour after the commencement of the meeting, or during a meeting the quorum ceases to be present, the consequences would be that the meeting must stand adjourned to the same day in the coming week at the same time and place, or to the time and location as the directors may specify.

Resolutions

The resolution requisite to satisfy the decision of the commonhold association at general meetings varies depending on the nature of the subject of the matters concerned. The rules on resolution are given by article 22 of the articles of association. While an ‘ordinary resolution’, i.e. a simple majority of the votes of the members having cast their votes, suffices for the great majority of these affairs, matters of grave consequence or those in which more substantial interest require sanction by special (75 percent of the votes of the members voting) or even unanimous resolutions (100 percent of the votes of the members voting). These requirements, particularly the part on the ‘percent of the votes of the members voting’ make a great contrast with that of

a specified majority, which demand 80 or 100 percent of the membership (instead of merely those having cast their votes). Listed below in tabular form are some frequently encountered matters and the corresponding resolution required[54].

Matters for which ordinary resolution (i.e. resolutions requiring a simple majority of the votes of the members voting) only are required:

1. Whether a director should be voted out of office
2. Whether to approve a contract with a managing agent
3. Whether to appoint a committee
4. Whether to add, delete, or amend any rule contained in the default of optional provisions of the commonhold community statement
5. Whether to change the size of a commonhold unit or the common parts with the consent of the unit-holder and / or registered chargee
6. Whether to alter the common parts
7. Whether (with the consent of the developer) to amend the development rights

Matters for which a special majority (75 percent) of the votes of the members voting is required:

1. Whether to authorize the transfer of part of a commonhold unit
2. Whether the directors of the commonhold association should be entitled to any remuneration and, if so, the amount
3. Approval of a commonhold assessment
4. Approval of a reserve fund levy at an annual general meeting

[54] Fetherstonhaugh, G., Sefton, M. and Peters, E. (2004) Commonhold, Oxford University Press

5. Whether to make a provision in place of a default provision in the commonhold community statement
6. Whether (with the consent of the unit-holder) to change the permitted use of a commonhold unit
7. Whether to change the percentage of the commonhold assessment or reserve fund levies allocated to a commonhold unit
8. Whether to change the restrictions on the limited use areas

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Matters for which the unanimous votes of all the members voting is required:

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1. Whether to permit the creation of a charge over the common parts of the commonhold
2. Applications to add land to a commonhold
3. Whether to change the allocation of the votes given to a commonhold unit

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Matters for which a specific majority of 80 or 100 percent[55] of the membership is required:

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1. Whether to voluntarily wind up the commonhold association

4.4.4 Dispute resolution and sanction system

The approach under the Commonhold and Leasehold Reform Act 2002 to dispute resolution

The system of sanctioning is an indispensable element within a common pool resource management organization that should always be introduced with an

[55] The percentage of the resolution determines the corresponding steps to be taken for the winding-up. The main difference lies in the court's intervention in the absence of unanimity.

extensive dispute resolution mechanism as a necessary complement. The Commonhold and Leasehold Reform Act 2002 offers a comprehensive system covering both.

While litigation is still treated as a remedy of last resort, the institution of Commonhold encourages the parties in disputes to engage in alternative dispute resolution which range from a mandatory internal complaints procedure at the lowest level, to the appointment of an ombudsman, arbitrator or mediator. This underlying principle of dispute resolution, in spite of no express provisions were written to such effects, were made patent in the speech of the Parliamentary Secretary, Lord Chancellors' Department, during the Second Reading of the Commonhold Bill in the House of Commons:

'The commonhold scheme will provide for the enforcement of rights and duties between unit-holders and the commonhold association. Where internal dispute arises, we intend that the commonhold association and unit-holders should undertake a three-step process, including alternative dispute resolution, to resolve any conflict.

Assuming that the informal processes fail, the first formal process will be an internal complaints procedure. Secondly, under clause 41, we will prescribe the use of the commonhold ombudsman. The commonhold ombudsman will be modeled on the independent housing ombudsman, who has a wide range of dispute resolution procedures at his disposal, including arbitration, mediation and adjudication. The last recourse available will be to the court.'[56]

[56] Official Report, House of Commons, 8 January 2002; col 425

It is accordingly of the government's view that the mechanism for sanction and dispute resolution should encompass informal steps and a formal three-step process. The policy aims to keep dispute resolution internal to the commonhold association with as little resort to outsiders' intervention such as the court's as possible.

Sources of duties

Prerequisite to sanctions by any means is a clearly delineated scope of duties the parties in the commonhold should fulfill, failing which would constitute to a breach. Under the Commonhold and Leasehold Reform Act 2002 there are three identifiable references of the duties imposed on the commonhold association, the members of the association and in some cases, their tenants. They are:

i). The commonhold community statement, the contents of which are prescribed by regulations

ii). The memorandum and articles of association of the commonhold association, the contents of which are also prescribed by regulations

iii). Other stipulations of the Commonhold and Leasehold Reform Act 2002 or regulations promulgated under the Act

The commonhold association's response to a breach

The Commonhold and Leasehold Reform Act 2002 impose the duty of policing within the commonhold on the board of directors. It provides that 'the directors of a commonhold association shall exercise their powers so as to permit or facilitates so far as possible the exercise by each unit-hold of his rights, and the enjoyment by each

unit-holder of the freehold estate in his unit'[57]. The precise powers of enforcement in the directors' arsenal, as the Act stipulates, are 'right, power, or procedure conferred or created by virtue of section 37 for the purpose of preventing, remedying or curtailing a failure on the part of a unit-holder to comply with a requirement or duty imposed on him by virtue of the commonhold community statement or a provision of this Part'[58]. Notwithstanding the duty of enforcement of the directors, the Act adds that the board of directors 'need not take action if they reasonably think that inaction is in the best interests of establishing or maintaining harmonious relationship between all the unit-holders, and that it will not cause any unit-holder (other than the defaulter) significant loss or significant disadvantage'.[59]

Having considered the duties imposed and powers conferred by the Commonhold and Leasehold Reform Act 2002, it becomes apparent that the reason steps the board of directors should take in the event of a breach of duty by a unit-holder would not deviate much from the followings:

a. The directors should first refer to their powers of enforcement given by the regulations promulgated under section 37(1) of the Act. It is equally important to decide if any action should be taken for a harmonious commonhold environment.
b. If they are of the view that some form of sanction is appropriate, they should nonetheless make an attempt of informal resolution of the matter. This can be in the form of a private negotiation or discussion between the breaching unit-holder and the directors.
c. If the informal resolution attempt turned out to be futile, it is reasonable for the

[57] Section 35(1), Commonhold and Leasehold Reform Act 2002
[58] Section 35(2), Commonhold and Leasehold Reform Act 2002
[59] Section 35(3)(a), Commonhold and Leasehold Reform Act 2002

directors to activate the internal complaints procedures.

d. If the internal complaints procedure did not resolve the issues, the directors should consider whether the dispute is one suitable to be brought forward to the commonhold ombudsman.
e. In case the situation caused by the unit-holder's breach of duties is so urgent that it requires immediate attention, for instance, repairing a dangerous structure in the unit, the directors should consider sending relief themselves. They should serve upon the defaulting unit-holder an indemnity notice, provided that their commonhold community statement so permits.
f. Instigation of legal procedures should be last resort of the directors when everything stated failed to resolve the disputes.

The internal complaints procedure is established as a screening system for the purpose of internalizing dispute resolution within the self-governing commonhold association on one hand, while on the other curtailing unnecessary lawsuits arising from disputes which could have been resolved by any other means but litigation.

Therefore it is not a matter of choice that the parties in grievance instigate the commonhold association's internal complaints procedure prior to engagement of the commonhold ombudsman or litigation. This is made clear in the commonhold community statement that, bar that urgency is involved,

a. the dispute may not be litigated unless it has first been referred to the ombudsman; and
b. the dispute may not be referred to the ombudsman unless the notice procedure (i.e. the internal complaints procedure) has first been attempted and 21 days has elapsed sine then.

In practice, if the matters are to be brought into the formal dispute resolution arena and the mandatory internal complaints procedure initiated, the complainants are required to serve a 'complaints notice' in a prescribed form to the commonhold association outlying the issues. The commonhold association should, after gathering and examining necessary details of the complaints, come to a conclusion either dismissing the complaints with a 'reply notice' or taking action of enforcement against the defaulting unit-holder by serving him a 'default notice'. There notices must also be in accordance with the proscribed forms supplied in the annexation to the commonhold community statement.

The commonhold ombudsman scheme

The commonhold ombudsman scheme set up under the regulations promulgated under the Commonhold and Leasehold Reform Act 2002. In essence, the ombudsman is an independent external body, designation of which must be sanctioned by the Lord Chancellor, bearing the responsibility of handling disputes of all its members. Membership of the commonhold ombudsman scheme is available only to commonhold-associations but not the unit-holders, and it is compulsory[60].

The ombudsman is duty-bound to investigate any complaints referred to him. He must identify and reject the ones have not gone through the commonhold association's internal complaints procedures or those not falling within the terms of the commonhold ombudsman scheme. For the valid complaints, the ombudsman should look into all the facts of the case and take the most suitable steps to resolve the disputes, which may include facilitating local settlement. The ombudsman may also

[60] Regulation 16, Commonhold Regulations

introduce other forms of external alternate disputes resolution mechanisms like mediation or arbitration similar to their counterparts for construction disputes and personal injury. If his endeavour as such bears not fruit, he must based on his findings decide which remedies open to him should apply and convey the messages to the commonhold association and all parties involved.

There is doubt, however, over the powers available to the commonhold ombudsman. Other than providing that the commomhold ombudsman is entitled to award compensation[61], The Commonhold and Leasehold Reform Act 2002 makes no clear provisions on the powers or remedies available to him. It is suggested, by reference to the Independent Housing Ombudsman Scheme (IOH Scheme), a similar system in the UK for resolution of disputes between its members landlords (housing associations) and people receiving their service, the powers of the commonhold ombudsman is likely to include that granted in the IOH Scheme.

Decision makers' access to relevant information

Relevant information for the purpose of decision making in the commonhold association and other common pool resource management organizations as well may be grouped into two categories, records of crucial documents and the changing conditions of the commonhold.

Record keeping

Management of the commonhold association often encounters the needs to refer to pervious documents in dealing with affairs the commonhold such as determining eligibility of a party or figuring out what remedies may be given. It is made

[61] Section 42(2)(g), The Commonhold and Leasehold Reform Act 2002

mandatory by the Commonhold and Leasehold Reform Act and regulations promulgated thereunder that an array of records of essential documents must be kept by the commonhold association. They are:

a. a register of members
b. minutes of appointments of officers
c. minutes of meetings
d. copies of the original and any amended versions of the commonhold community statement
e. accounting records
f. insurance records
g. register of tenants
h. land registration documents

General meetings of the members of the commonhold association

Knowledge of the changing conditions of the commonhold is as important as records of documents in respect of prompt decision making. Access of knowledge of this kind requires what Ostrom (1990) observed as a drive towards batter common pool resources management, a medium for exchange of information among appropriators regarding aspects of the commons they have interests in. In the Commonhold scenario, general meetings give the members and directors of commonhold association opportunities to put forward and transact the business of the commonhold. The articles of association stipulates that the commonhold association must hold an annual general meeting[62] and at least one additional general meeting known as 'interim

[62] Article 6, articles of association

general meetings'[63]. To facilitate communication of the issues within the commonhold, the articles of association also imposes a duty on the directors of the commonhold association to present an interim review of thee business and affairs of the commonhold association since the preceding annual general meeting alongside other matters put forward for resolution[64].

4.5 Operational level

4.5.1 Boundaries

A built environment in commonhold is quite different from the standard commons like water reserve or a wood in the sense that only areas defined as common parts fall within the scope of common pool resources. Significant portions of the commonhold are commonhold units held in private ownership by unit-holders. This stresses the necessity of unambiguous delineation of the boundaries between the two types of areas.

The definition of boundaries is, together with other operational rules, made in the commonhold community statement of the commonhold association.

The extent of common parts

The Commonhold and Leasehold Reform Act 2002 gives a concise definition of the common parts of commonhold, which is every part of the commonhold not for the time being a commonhold unit. In light of this provision, the commonhold community statement contains no otiose provisions concerning the extent of common parts.

[63] Article 7, articles of association
[64] Article 7, articles of association

Description of commonhold units

As mentioned above, the Commonhold and Leasehold Reform Act 2002 relies very much on description of the commonhold units, made in the commonhold community statement, for a definition of the boundaries. The Act permits definition of the extent of a commonhold unit by:

a. Referring to an area subject to the exclusion of specified structures, fittings, apparatus or appurtenances with the area[65]. By virtue of this provision, any pipes or conduits running through a commonhold unit may be excluded from the unit and retained by the commonhold association if it is so wished.
b. Excluding the structures which delineate an area referred to[66]. Accordingly, it is possible, for instance, to exclude the external walls of a multi-storey building from the unit.
c. Referring to two or more areas, whether or not contiguous[67]. It is thus possible for a unit to encompass, for example, a flat and a garage.

Furthermore, to allow for pinpoint accuracy in defining the boundaries of the commonhold units, the Commonhold and Leasehold Reform Act 2002 requires, in addition to the description of the unit, its address, the commonhold number assigned and indications of parts to be excluded as stated above, a plan attached to the commonhold community statement showing each of the commonhold units. The plan must follow a set of requirements, which would ensure a high degree of accuracy.

Limited use common parts

[65] Section 11(3)(b), Commonhold and Leasehold Reform Act 2002
[66] Section 11(3)(c), Commonhold and Leasehold Reform Act 2002
[67] Section 11(3)(d), Commonhold and Leasehold Reform Act 2002

In many buildings with communal facilities, certain areas of the common parts are not dedicated to general amenity. Some obvious examples of areas as such are:

a. Ancillary space for plants and machinery, which may be the lift motor room in a multi-storey building or air-conditioner room in an office building. These areas are to be kept secure with access limited to authorized personnel.
b. Storage or park spaces, which are to be let our to visitors and the like
c. Garden area or turf which are provided for the aesthetics of the commonhold but restricted to the use of certain unit-holders.

The commonhold community statement permits these kinds of bans and zoning of areas in which the bans take effects. It states that 'limited use areas may only be used by authorized persons and in a manner consistent with the authorized use specified in Table 4 of Part II of this commonhold community statement.'[68]

4.5.2 Appropriation rules

In order to sustain a health commons, the draft prescribed form of the commonhold community statement provides a set of appropriation rule to regulate unit-holders' behaviour in the day-to-day operation of the commonhold. Part III of the draft prescribed form contains a number of miscellaneous rules to control the use of both the common parts and units of the commonhold. The followings are barely a short abstract of the long list of provisions appearing in the original draft commonhold community statement. These items concern with areas where conflicts usually arise.

i). Access

[68] Rule 10, commonhold community statement

No unit-holders or his invitees shall do any thing or leave or permit to be left any goods, rubbish or other object which obstructs or hinders lawful access to any part of the Commonhold.

ii). Aerials and satellite dishes

No unit-holders or his invitees shall erect or permit to project outside his Commonhold Unit or into the Common Parts any radio or television aerial or satellite dish.

iii). Nuisance and annoyance

A unit-holder must not, and must take reasonable steps to ensure that his invitees do not, behave in a way or create any sound or noise which causes or is likely to cause any annoyance, nuisance, injury or disturbance to other unit-holders, or to any other person lawfully on the commonhold, or to the occupiers of adjoining buildings or premises.

iv). Hazardous materials

A unit-holder or his invitees may not, without the written consent of the Board of Directors, bring onto the commonhold or store in any part thereof, any flammable, hazardous or noxious substance. This does not apply to the storage of fuel in the fuel tank of a vehicle or in a small reserve tank for use in connection with the vehicle.

v). Pets

No animals may be kept or brought onto the commonhold without the written consent of the Board of Directors

Owing to the Department of Constitutional Affairs' recognition of the freedom of commonhold associations to devise their own sets of rules fitting the commonhold situation, quite a lot of the less significant rules are dropped from the mandatory list

and turned optional. It is suggested that, as a matter of prudence, commonhold associations should enlist these provision in their commonhold community statement nonetheless, depending on the conditions and needs of the commonhold.

Chapter 5

Implications

5.1 Constitutional level

As it was noted in the very beginning, the constitutional level rules of decision first come into existence as the foundation upon which the lower collective choice and operational rules are built. This implies the constitutional rules also limit the lower level rules to the scope of actions they permit. Within the ambit of the institution of Commonhold, the decision making rules exhibits a high degree of consistency of consistency between the levels. Further discussion below will come to similar conclusion. As a result of the high degree of consistency, the effect of the constitutional rules, whether positive or negative, will be at a state close to the fullest.

As the three-level analysis of the decision making rules suggest, the UK government has been sustaining a seemingly unchallengeable constitutional background for the operation of Commonhold. The well-defined and protected individual rights, a high degree of autonomy of self-governing commonhold associations, high standard of rule of law upholding justice and fairness, all these make invaluable contribution to this cause, as does the sophisticated private property right system. However, in the course of defending the private property right of unit-holders as a freeholder of their units, which is a matter of constitutional choice, much hindrance surfaces at the lower decision making levels. The contradiction-free hierarchy and well-preserved private property right system have summed up to negative impact on the collective choice and operational levels in that a great deal of rights of enforcement and remedies are

scarified.

Take maintenance and repair, an indispensable element of building management, as an example. In most institution relating to building co-ownership and management maintenance and repair are so crucial that the government will make express provisions imposing on certain party an obligation to keep the common parts and the units in good condition. For instance, the Hong Kong's Building Management Ordinance stipulates that 'the corporation shall maintain the common parts and the property of the corporation in a state of good and serviceable repair and clean condition'[69]; while the deed of mutual covenant will often include a clause requiring the owners to do something similar on his unit. In the Commonhold institution, Section 14(2) and 26(c) of the Commonhold and Leasehold Reform Act 2002 require the commonhold community statement to make provision regulating respectively the maintenance and repair of the commonhold units and the common parts. Included in the original draft of the commonhold community statement are a series of rules giving these effects:

i). Each unit-holder should be responsible for the repair and maintenance of the interior of his commonhold unit

ii). The commonhold association should be responsible for the repair and maintenance of the exterior of the commonhold units

iii). The commonhold association should repair and maintain the common parts.

The following revised version of the document has seen significant departure from this maintenance framework. While the commonhold association is still given the

[69] Section 18(1)(a) Building Management Ordinance

duty to maintain the common parts, the obligation for the owners to maintain and repair their units is dropped. This arrangement is explained in the Post-Consultation Report dated August 2003:

‘Individual commonholds would be able to impose obligations on unit-holders to maintain their units if they so wish but we do not consider that a general mandatory obligation to keep a unit in good repair would be appropriate for a freehold owner, or necessary for a structurally independent unit. Similarly, an obligation to keep a unit clean does not seem to be appropriate to us. … It will bring commonhold obligations more in line with freehold expectations and will also have the advantage of minimizing the number of rights that are required over units or parts of units.’

This short abstract of the UK government’s view might sounds absurd were it not the consideration of freeholders’ right.

Throughout the three levels of rules the government encountered plentiful temptation of better means of enforcement and remedies at the cost of violating or circumventing the private property right rules, yet unwaveringly it has resisted them all and repeatedly stressed its determination in blurring the line between freehold in commonhold units and the traditional freehold ownership. Nonetheless, there is no denying that the government’s adherence to the constitutional principle of protecting the freeholders’ rights has brought the Commonhold institution its batch of shortcomings and flaws. More on these happening at the collective choice and operation level are discussed below respectively.

5.2 Collective choice level

When it comes to the collective choice level, the institution of Commonhold outright excels most non-statutory systems such as the common law co-ownership prevailing in Hong Kong. Under the current institutional setting in Hong Kong statutory intervention to prescribe officially recognized, self-governing incorporation of owners is non-existence. Establishment of self-governing bodies relies heavily on the deed of mutual covenant provisions, meaning the matter is left for the drafting party, usually the developer, to decide, or in quite some cases, to ignore. In such case where the deed of mutual covenant is silent on the matter, incorporation depends on initiative of the owners, who are in a position lack of coordination by a central authority, to convene a meeting and pass the related resolution. These arrangements, particularly the last, are dubious given that the primary objective justifying the self-governing organizations' existence is to rectify the absence of central authority coordinating owners' actions.

In contrast, the self-governing commonhold association as a company limited by guarantee must be formally incorporated and registered to complete the process of adopting the Commonhold scheme. The formation procedures are clean and free from the complications haunting non-statutory systems. With clearly defined authority and scope of actions, the commonhold association effectively provides centralized enforcement against owners' undesirable behaviours and redresses the problems of over-utilization of common parts and maximized the use of units as the cost of nuisance to others. On the other hand transaction costs shrink in the presence of centralized coordination, implying that unit-holders should find it less difficult to agree on joint payment for maintenance and the like.

In addition to formation of a self-governing organization, the preconditions for desirable common pool resource management demand a small group representing the all participants of collective choice decision making and a sound election mechanism to select the representatives. The first part is satisfied by appointment of the board of director of the commonhold association. Specifically, these representatives are given the duty to oversee the agent's functioning, which they should never hesitate to fulfill considering that the Commonhold and Leasehold Reform Act 2002 unmistakably stipulates that directors' delegation of their powers would not exempt their liabilities for non-performance of their duties. These arrangements, under which the individual owner principals, represented by the directors, will be united as a single entity in dealing with the managing agent and give only instructions out of coordinated decision among themselves, are the key to reverse the abnormal 'powerful agent, weak individual principals' relationship that has long been giving rise to excuse for managing agents not acting in the owners' best interest. Moreover, the agent costs are minimized as a result.

The selection criteria for this crucial representing group, albeit a product of careful deliberation, may attract criticism. While the Commonhold and Leasehold Reform Act 2002 prescribes that the membership should comprise unit-holders only save for the initial subscriber and / or developer, it does not prohibit non-members from taking up the post of directors as representatives of the members. Although this approach has the advantages that professionals, whose experience and expertise would help in running the commonhold, can be hired for the directors' post, it has its major downsides which should not be underestimated. Above all, an additional layer of 'agency relationship' is established. This agency relationship with a non-member director is different from one with a member director in that the divergence of a third

party agent (non-member director)'s own interest from the owner principals' is far more significant compared with that in a scenario with a member being the director. Then there is the possibility that non-member directors, who are given the power to nominate new directors as member directors are, may collaborate to dominate the representing group, although the members retain the final right in passing the nomination resolution. These inadequacies may easily put the quality of representation and even the sovereignty of commonhold association members at risk.

Currently it is provided that the board should include at least one member director. This prevention of total takeover can be lacking in commonhold with larger group of representatives. In view of the government intention that the quorum should increase with the membership, the minimum number of member should be modeled likewise. It will be of the unit-holders' benefit to have the minimum set at 50 percent of the total size of the board.

While the decision making mechanism is largely sound and successful in fulfilling the preconditions, it also has certain drawbacks. As the analysis reveals, decision making in the commonhold association features a 'one vote per unit' approach of vote allocation, yet by reason of procedural requirements the principle of 'one vote per unit' is not fairly realized in the default setting. Nonetheless, what actually sparks arguments is the potential unfairness which might emerge in certain scenarios under this prescribed approach of allocation of vote, even if the said inadequacies in implementing the 'one vote per unit' rule are responded with proper redress. The 'one vote per unit' prescription leading to unfairness is recognized in the Consultation Paper, as Paragraph 83 reads:

‘It may not … reflect the actual make-up of the commonhold. If we consider the example of a mixed-use commonhold, there may be one very large unit on the ground floor, perhaps a supermarket, above this there may be ten or more smaller residential units. It may create an unfair environment if the supermarket only exercises the same voting strength as each residential unit. On the other hand, if one person owns multiple units he or she may exercise the voting rights for every unit owned, which may effectively allow one person to dominate proceedings in the commonhold.’

Having perceived the potential unfairness the government has made the following mitigation proposals in the Consultation Paper:

a. Allocation of voting rights by unit area or volume
b. Allocation of voting rights by value of unit
c. Restriction of voting by category of unit-holders, either residential or commercial, to matters relevant to and affecting the category of unit-holders concerned
d. Prescription against excessive use of voting rights by a multiple unit-holder

It is not difficult to conceive the complexity these alternatives would introduce and unfairness that may creep into the decision making mechanism somehow. For this reason the government has decided to adopt a solution explained by the Department of Constitutional Affairs in its Post-Consultation Report dated August 2003:

‘In light of the wide range of views expressed by respondents we are now considering adopting a less prescriptive approach, using one member, one vote as a default provision but allowing commonhold associations the discretion to create their own

system of voting to reflect the circumstances of the individual commonhold. We anticipate that this would lead to some commonholds adopting alternative voting structures of the kinds detailed in the Consultation Paper. Other may use the distribution of units between properties as another way of achieving the required balance in voting rights.'

It is seen that although to certain extent uniformity is scarified, the flexible approach is realization of congruence between governing rules and local conditions, a common characteristic of long-enduring common pool resource institutions which Ostrom (1990) has turned into one of the design principles for common pool resource institutions.

So far the institution of Commonhold has met every precondition for positive result of self-governance and sustainable use of common parts. However, there should be some reservation on this when it comes to sanction. The sanction system, or more precisely, the system of dispute resolution, virtually offers no real penalties for defaulting unit-holders. One subject of fierce debate during the passage of the Commonhold Bill was that the commonhold association lacks the much needed power of sanction. The unavailability of forfeiture as an effective means of sanction, being the weakest link in the system, faced wild attacks during the Committee Stage of the Commonhold Bill. A great number of speeches was given in support of allowing forfeiture as a remedy:

'It is not clear to me why there should be no power of forfeiture in the arrangements for managing commonhold properties. Surely the most effective sanction against a unit-holder failing to discharge his financial (or other) obligations to the association is to charge the unit as security for due performance. Unless the association has such

security, its only ultimate remedy is to prove in the defaulting unit-holder's bankruptcy, in which it may recover only a small dividend.'[70]

'At present, where you have landlords and tenants, the former can use the threat of forfeiture. In practice, forfeiture is very rarely enforced because the landlord has to serve a notice calling for any defects to be remedied and give time for compliance under Section 146 of the Law of Property Act. Again, where the failure is in the payment of rent, similar provisions apply enabling a tenant to obtain relief, but such relief can only be obtained on payment on what is due. Therefore, that is a powerful and effective weapon.

Of course, that weapon could be too effective. In the hands of aggressive landlords it can be used too soon, or too frequently, and can be a cause of serious concern to tenants who are faced with inappropriate us of forfeiture proceedings. Any equivalent in the case of a commonhold association is far less likely to happen because the association is also made up of the various members. They know that any threat that they use against a recalcitrant member of the association is one that can also be used against them. Quite frankly, abuse of any power equivalent to forfeiture in the case of a commonhold association is a very remote danger.'[71]

In spite of all these endorsement, the government reaffirm its stand with the following condemnation of forfeiture as a remedy in commonhold:

'We remain firmly of the opinion that forfeiture, or any similar provision by

[70] Official Report, House of Lords, 16 October 2001; col 499
[71] Official Report, House of Lords, 16 October 2001; col 505

whatever other name, is quite inappropriate for commonhold. … Behind every threat there must lie the possibility of action, and the possibility of a right to forfeiture being realized in the commonhold context remains for us anathema.

We are apprehensive about importing a means of prematurely terminating a lease into commonhold because one of the fundamental precepts of commonhold is freehold ownership of units by unit-holders. We cannot conceive the merit of marrying together two concepts that are on the face of it so incompatible.'[72]

'A commonhold unit is a freehold estate in commonhold land. Forfeiture is a process used by the holder of a superior interest to prematurely terminate an inferior interest in his property. Termination of the interest by the holder of the superior interest occurs because of the failure of the holder of the inferior interest to fulfill an obligation owed to the holder of the superior interest. Such a relationship simply does not exist, and is not intended to exist, within commonhold. We are talking about unit-holders who have a parity of position without superiority or inferiority. There is no one with an interest in a commonhold unit superior to that of the unit-holder. The commonhold association is the registered proprietor of the freehold estate in the common parts but has no claim to the units, nor should it, we believe.'[73]

It become apparent that forfeiture undermining the rights of unit-holders' as freeholders is what ultimately worries the government. In effect, all this crossfire boils down to a single question: whether the expediency of introducing forfeiture as an effective remedy could outweigh the consistency of rule in the hierarchical decision

[72] Official Report, House of Lords, 16 October 2001; col 508
[73] Official Report, House of Lords, 16 October 2001; col 509

making structure of the Commonhold institution. Obviously, as it was just explained in the above constitutional level section, the government's answer is negative. Indeed this is yet another living proof of how some good-intended constitutional choice has unexpectedly cause hindrance to the lower level decision making. There cannot be too much restatement that the government's strict adherence to the constitutional principle of protecting the freeholders' rights is by no means inappropriate. What ought to be done to complement this systemic imperfection is balancing the outcomes, something for which the UK government has demonstrated its capability in this scenario.

Notwithstanding the above, the dispute resolution system has effectively given rise to a practice of minimizing reliance on external intervention (that of the court, for example). When private negotiation within the commonhold bears no fruits and the matters must be referred to an external authority for a judgment, the institution offers an easily accessible, inexpensive ombudsman scheme which not only plays a role similar to the court but also facilitate reconciliation in the process, essentially reducing the need for costly litigation.

Finally, the precondition of access to relevant information is also met. With the commonhold association which itself boosts communication among members and prescribed general meetings as an ideal medium in which important matters are discussed among all members, information asymmetry can well be avoided.

5.3 Operational level

The two preconditions at operational level, definition of boundaries and congruence between appropriation and provision rules and local conditions, are fulfilled. Attached to the commonhold community statement is a plan that allow for pinpoint accuracy in

defining the boundaries of the commonhold units. Definition of common parts, which is the areas not defined as commonhold units, is clearly made accordingly.

In contrast, the appropriation rules, or the ‘house rules’ governing operation of the commonhold were intentionally made less prescriptive by turning quite a number of the less significant rules optional. The recognition of the freedom of commonhold associations to devise their own sets of rules fitting the commonhold situation gives a sign of accomplishment of congruence between appropriation and provision rules and local conditions, attaining one of the seven leading design principles identified by Ostrom (1990), which, if all fulfilled, would bring about long-enduring common pool resources (in this case, common parts) governance.

5.4 Consistency between levels of rules

Evidenced by various cases discussed from all levels with the constitutional principle of freehold ownership safeguarded at the sacrifice of unavailability of sanction by forfeiture at the collective choice level as the most prominent representative, the institution of Commonhold exhibits a high degree of consistency in the hierarchical decision making structure. This accounts for numerous scholars’ call for a statutory system like Commonhold (Walters and Kent, 2000) to replace the non-statutory common law co-ownership system in Hong Kong, the decision making hierarchy of the latter being a mess according to Walters and Kent’s (2000) conclusion from the case of Grace International Ltd. v. Incorporated owners of Fontana Gardens & Ors [1996] 4HKC 635 (HC).

The high degree of consistency has endowed the Commonhold institution with an advantage that when problems strike, the source of the problems can be identified at

ease. There is no worry about the complication of problems hidden under complex conflicts of rules of different levels like in the Fontana Gardens case ‘failure of the collective choice level also leads to a failure to enforce operational level rules’ (Walters and Kent, 2000). The unambiguous, confusion-free decision making mechanism, while partly attributable to the carefully drafted prescribed forms of documents, should also be accredited to the consistent framework.

Chapter 6

Conclusion

6.1 Conclusion

Meeting a great majority of Wang's preconditions which incorporate Ostrom's (1990) design principles for long-enduring common pool resource governance, the institution of commonhold should, according to Ostrom (1990), have a very positive result and achieve sustainable development of common pool resources (the common parts, in the case of building management). Moreover, it is shown that the institution is effective in preventing problems of poor management that would commonly arise in non-statutory co-ownership system like Hong Kong's.

However, the institution of Commonhold has its batch of shortcomings and flaws. What might not have not been explicitly given consideration by certain advocators, as various examples in the three-level analysis has suggested, is that even thought a high degree of consistency in the hierarchical structure of decision making is maintained, there are chances that constitutional or collective choice out of good intention can result in hindrance in decision making in lower levels. In these cases, rigid adherence is by no means the proper solution. Rather, the systemic imperfection necessitates complements of sensible judgment and balance of outcomes.

Overall, judging from the decision making aspect, Commonhold is a structurally and elementally sound institution, yet definitely it is never a panacea for all inadequacies in management of multi-storey buildings and developments of other kinds in common

ownership. As Walters and Kent (2000) suggest, ‘like strata title systems in other jurisdictions, it [Commonhold] would establish a new form of relationship between co-owners and managers that could have a significant effect upon transaction costs associated with community living’.

6.2 Limitation of the study

In addition to physical assets and decision making arrangements, Oakerson’s (1990) framework entails a third element leading to the outcome, patterns of interaction. While the study has shown that physical assets are unlikely to experience drastic change of any kind which justified its focus on decision making arrangements only, patterns of interaction between rules and physical assets which might be as detailed as how house rules are defined in different commonholds, is excluded from the scope of the study. This accounts for the comparably brief operational level discussion in the study.

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